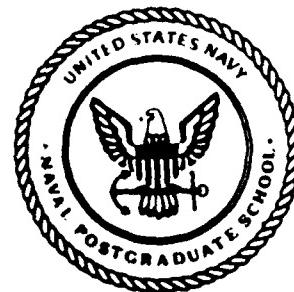


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## THEESIS

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THE POST-AWARD COSTS OF CONTRACTING OUT:  
THE U.S. NAVY'S IMPLEMENTATION OF  
OMB CIRCULAR A-76

by

Nancy Sage Cole

and

Charles Pegram Cole, Jr.

June 1988

Thesis Advisor:

Paul M. Carrick

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The Post-Award Costs of Contracting Out:  
The U.S. Navy's Implementation of OMB Circular A-76

by

Nancy S. Cole  
Lieutenant, Supply Corps, United States Navy  
B.A., State University of New York, 1974

and

Charles P. Cole, Jr.  
Lieutenant, Supply Corps, United States Navy  
B.S., University of North Carolina, 1974

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June 1988

Authors:

Nancy S. Cole  
Nancy S. Cole

Charles P. Cole, Jr.  
Charles P. Cole, Jr.

Approved by:

Paul M. Carrick  
Paul M. Carrick, Thesis Advisor

Larry R. Jones  
Larry R. Jones, Second Reader

David R. Whipple, Chairman  
Department of Administrative Sciences

James M. Freygen,  
Acting Dean of Information and Policy Sciences

## ABSTRACT

The Commercial Activities program as delineated by OMB Circular A-76 has been controversial since its inception. One area of continuing controversy is the accuracy of pre-award cost estimates for estimating post-award program savings in operations that are contracted out. This thesis examines the post-award results of contracting out and identifies those costs that are either underestimated or not accounted for in the cost comparison process. Research was conducted on 14 West Coast activities that contracted out a food service operation, storage and warehousing operation, or both under a multi-function contract. The issues identified by the study include: the need for post-award guidance and policy, the need for increased claimant guidance at the field level, the absence of an adequate cost accounting system and post-award program controls, the need for increased contract administration staffing, a problem with budget flexibility at activities that have contracted out and continuing problems with performance definition.



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## TABLE OF CONTENTS

I.	INTRODUCTION -----	1
A.	GENERAL BACKGROUND -----	1
B.	AREA OF RESEARCH -----	2
C.	THEORETICAL ISSUES -----	3
D.	SCOPE OF THE STUDY -----	8
E.	THESIS ORGANISATION -----	9
II.	BACKGROUND -----	11
A.	HISTORY OF THE COMMERCIAL ACTIVITIES PROGRAM -----	11
B.	PROGRAM DESCRIPTION AND COST COMPARISON OVERVIEW -----	19
C.	PRACTICAL ISSUES -----	24
D.	STATISTICAL OVERVIEW -----	27
III.	METHODOLOGY AND DATA PRESENTATION -----	30
A.	SAMPLE SELECTION -----	30
B.	METHODOLOGY -----	32
C.	DEMOGRAPHICS OF THE SAMPLE -----	33
D.	RESULTS OF DATA COLLECTION -----	34
1.	Questionnaire Results -----	39
2.	Informal Interview Results -----	44
a.	Sample Respondents -----	44
b.	Major and Sub-Claimant Interviews ---	49
IV.	DATA ANALYSIS AND ISSUE IDENTIFICATION -----	55
A.	PERFORMANCE DATA -----	55

B.	ACCURACY OF COSTS AND BUDGETARY IMPLICATIONS -----	66
C.	TRAINING ISSUES -----	73
D.	SUMMARY OF DATA -----	75
V.	CONCLUSIONS AND RECOMMENDATIONS -----	77
A.	CONCLUSIONS -----	77
B.	RECOMMENDATIONS -----	79
1.	Need for Centralized Claimant Guidance --	80
2.	Need for Post-Award Guidance and Policy -	81
3.	Problems in Adequately Defining Performance -----	81
4.	Impact of Mobilization on Contractor Operations -----	82
5.	Absence of an Adequate Cost Accounting System -----	83
6.	Understaffing of Contract Administration -----	84
7.	Loss of Budget Flexibility -----	84
8.	Contract Type and Method of Procurement -	85
9.	CA Training Requirements -----	85
C.	AREAS FOR FURTHER RESEARCH -----	87
APPENDIX A:	NAVY COMMERCIAL ACTIVITIES (CA) PROGRAM: PROGRAM ACCOMPLISHMENTS FYS 1979-1987 -----	88
APPENDIX B:	INTERVIEW QUESTIONNAIRE FOR CA POST- AWARD EXPERIENCES -----	98
LIST OF REFERENCES -----		104
INITIAL DISTRIBUTION LIST -----		106

## I. INTRODUCTION

### A. GENERAL BACKGROUND

In the process of governing, the Government should not compete with its citizens. The competitive enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength. In recognition of this principle, it has been and continues to be the general policy of the Government, to rely on commercial sources to supply the products and services the Government needs. [Ref. 1:p. 1-1]

This general policy has guided the development of the Commercial Activities (CA) program from its initial promulgation in Bureau of the Budget Bulletin 55-4 in the mid-fifties, until the latest iteration of OMB Circular A-76 in 1983. Although this basic policy has remained an integral part of the philosophy behind the CA program, the major emphasis has changed since 1979 from one of relying on the private sector, to one of only relying on the private sector if it is cost effective to do so [Ref. 2].

The switch to cost effectiveness as the primary impetus behind the program has led to the development of a lengthy and complex cost comparison process between government activities and commercial competitors. This cost comparison process is at the center of most controversy that surrounds the CA program. It will be examined closely in this study.

## B. AREA OF RESEARCH

Proponents of the CA program outline the tremendous cost savings that have accrued since its inception, relying heavily on the formal Navy accounting system to capture these costs. Opponents to the program propose that not all of the costs associated with program implementation are captured by the accounting system and that there are "hidden costs" which make implementation less than cost effective. At the center of this controversy is the assumption implicit in the CA program that a pre-award bid to perform a particular function is an accurate estimate of the actual post-award cost. The research study that supported this thesis focused on this aspect of the controversy, and in particular the so called "hidden costs" of contracting out or conversion of governmental functions to private sector operation in supply operations of the U.S. Navy. It examined those costs currently captured by the Navy's formal accounting and management information systems and assessed them for accuracy, relevance and completeness. The research also attempted to identify any relevant costs which have not been officially recorded, categorize them and determine their magnitude where possible.

An analytical framework of cost accounting theory was used as a basis for addressing the following research questions:

1. Are there unrecorded costs associated with contracting out a supply operation?

2. What is the magnitude of these unrecorded costs and what specifically are they?
3. What is the impact of these "hidden" costs on the activity, the units it supports, and the activity's major claimant?
4. Which unrecorded costs are most significant?
5. Are there ways to minimize these costs through acquisition control techniques, improved specification writing and/or quality control measures?
6. Is there a significant difference in the post-award performance effectiveness of supply operations that have been contracted out and those which haven't? If there are performance differences, what are those differences and what are their basic causes?

#### C. THEORETICAL ISSUES

Since 1979, the rationale for continuing the CA program has been an efficiency one. OPNAVNOTE 4860 states:

Over the years the Commercial Activities (CA) program has proven to be one of our most successful efficiency programs, generating significant resource savings through contract conversions and through the implementation of most efficient organizations when functions remain in-house. [Ref. 3:p. 1]

However, the implementation of efficiency measures in non-profit organizations, such as the Department of the Navy, is problematic when one considers the economic behavior that distinguishes such organizations from their profit-seeking brethren.

Essentially, the differences lie in the problems that a non-profit organization experiences in measuring output or benefits. In a profit-seeking enterprise, the output is translated into the single profit measure. In a non-profit organization, the relationship between costs and benefits,

and even the amount of benefits are difficult to measure. Therefore, the two primary performance measures that are scrutinized by the profit-oriented sector, efficiency and effectiveness, are more difficult to assess in a non-profit organization. Yet this is precisely what the CA program attempts to do, particularly in the cost comparison process.

The term "Commercial Activities" refers to those activities or functions within the Government that Government policy makers have decided can be performed by the commercial sector because they are inherently "commercial" in nature. Government activities, on the other hand, are those activities that by their very nature are governmental. They are defined to be those functions which have been characterized as follows:

...so intimately related to the public interest as to mandate performance by Government employees. These functions include those activities which require either the exercise of discretion in applying Government authority or the use of value judgment in making decisions for the Government. Governmental functions normally fall into two categories:

1. The Act of Governing. The discretionary exercise of Government authority. Examples include criminal investigations, prosecutions and other judicial functions; management of Government programs requiring value judgments, as in direction of the national defense; management and direction of the Military Services; activities performed exclusively by military personnel who are subject to deployment in a combat, combat support or combat service support role; conduct of foreign relations; selection of program priorities; direction of Federal employees; regulation of the use of space, oceans, navigable rivers and other natural resources; direction of intelligence and counter-intelligence operations; and regulation of industry and commerce, including food and drugs. Also included are contract administration, personnel management,

chaplains, staff judge advocate and other legal advisor) activities and managerial activities at the level in the organization where decision-making will affect program direction. Within the activities listed in this paragraph, there may be embedded CA functions, such as word processing and automatic data processing (ADP) support; these must be identified as reviewable under the provisions of this instruction. (Ref. 1)

### **2. Monetary Transactions and Entitlements**

Transactions and entitlements such as tax collection and revenue disbursements; control of the treasury accounts and money supply; and the administration of public trusts. (Ref. 1, pp. 1-7 and 1-8)

This distinction between governmental and commercial functions within a governmental activity assumes that there is, in fact, a way to decompose a government activity into a number of sub-functions where the output can be put into measurable terms and differentiated from other inter-related functions without impacting upon their output. Considerable debate centers on whether these distinctions can be made, especially in operations that are not "stand alone" in nature. Also, there is debate on the appropriateness of using efficiency measures as a basis for controlling these activities, particularly when outputs may not be reasonably quantifiable. Alternative means for making decisions in a non-profit environment will be explored in conjunction with the data analysis that will form the basis of this research.

In addition to the problems associated with trying to accurately reflect efficiency in Department of the Navy operations, there are also questions related to the concept of relevant costs. Accountants and managers use this concept to assist them in making choices between

alternatives. Budgeted and foster define relevant costs as those "expected future costs - expected future revenues; that will differ among alternatives" (Ref. 6:p. 200). They do not include costs that would be incurred regardless of which alternative is chosen, but do they include "sunk costs" - those costs which have already been incurred. For example, utility costs (a fixed cost) would be incurred regardless of whether the government or a contractor performs a function - assuming government facilities are used under either alternative. Therefore, this cost is irrelevant to the contracting out decision. Once all relevant costs for each of the two alternatives have been identified, an "incremental cost" can be determined. "An incremental cost is the difference in total cost between two alternatives" (Ref. 6:p. 201). The incremental cost is used as the basis for choosing between the alternatives. This paper will examine whether the Navy has, in fact, adhered to the principles of relevant costs when implementing the CA program and defining the cost comparison process.

A final issue examined in this study involves the complexities of performance definition and performance measurement. Because performance cannot be measured directly, "proxies" or surrogate measures are established and used as a means of assessing performance (or the quality of service). However,

Often, the units by which a commodity is exchanged differ from those for which it is desired. For example, tires are measured by ply, size and tread, whereas they are valued for strength, road-holding ability and longevity; oranges are sold by weight, which includes the seldom-wanted skin. [Ref. 5:p. 42]

Thus, the surrogate measures that are established to assess a contractor's performance may not accurately reflect the quality of that performance. Additionally, the Performance Requirements Summary that is generally used as the basis for deductions on CA contracts can easily become the focus for measurement manipulation. For instance, an apple is often judged for tastiness based upon the richness and intensity of its color. If the farmer determines a means to intensify the color of the apple without an accompanying enhancement in flavor, the consumer is often tricked into purchasing an inferior product. [Ref. 5] It is necessary to examine the CA program and its results in this context to determine if the Navy is getting a "redder apple" that lacks quality taste. Does the CA program as it is presently structured deal with the problems of performance measurement? Are all functions that have been defined as "commercial activities" sufficiently simple to allow for accurate performance definition? These questions and issues will serve as a theoretical focus for examining the practical issues and controversies that surround the cost comparison process and CA program implementation.

#### D. SCOPE OF THE STUDY

The scope of this study is limited to research of those Navy activities on the West Coast of the United States and the Hawaiian Islands that have undergone cost comparison studies under the auspices of the Commercial Activities program and have contracted out their supply operations--specifically, food service and storage and warehousing operations. There have been 823 cost comparison studies conducted by the Navy during the time period of October 1978 through November 1987. Of these 823, 101 studies have involved either a food service operation, a storage and warehousing operation or both (under one of the many umbrella-type service contracts that have been let under this program). Of the 101 studies involving either of these two functions or both, 27 involved activities located on the West Coast or Hawaii. Out of the 27 activities that have conducted cost comparison studies in these functional areas, 14 have contracted out the functions. It is these 14 activities that were the subject of the research conducted in this study. Research on these 14 activities focused specifically on the issues of performance effectiveness and the accuracy of the cost comparison process. Additionally, some preliminary research was conducted on the type of procurement method used and strategies for transition and quality assurance. The study was restricted to activities on the West Coast because of time limitations and

accessibility. Supply operations were chosen as the functional areas for examination because of the authors' familiarity with these type of operations and their knowledge of the technical issues involved.

Research was constrained by the lack of previous study of cost comparison and performance issues. Archival data on post-award performance is sparse. It is limited to a few Auditor General and Naval Audit Service reports commissioned by the CA Program Implementation offices, and a single performance study on Motor Vehicle Maintenance conducted by the RAND Corporation.

#### E. THESIS ORGANIZATION

This thesis is divided into five sections including this introductory section. The next section, Chapter II, provides a historical perspective of the Commercial Activities program from 1932 until the present. Also included is a description of the Commercial Activities program, the evolution of the underlying philosophy behind it, and some of the practical issues that have stirred controversies about the CA program and its implementation. Chapter III presents the methodology used in the conduct of this study and a synopsis of the results of the data gathering effort. Chapter IV is divided into three sub-sections. The first sub-section focuses on post-award performance and the issues of performance definition and measurement. The second sub-section analyzes the results of

data collection as they relate specifically to the issue of cost considerations and the issue of "relevant" costs. The third sub-section examines training issues within the CA program. The theoretical issues introduced in this section provide the analytical framework for analyzing the results of the data-gathering effort. Chapter V draws conclusions, identifies specific problems and issues, offers explanations for the issues where applicable, and proposes corrective actions as appropriate.

A compilation of overall program data, as assembled by OPNAV-443 for Fiscal Years 1979-1987 is included as Appendix A. A table presenting individual cost differentials for the 14 activities involved in the research study is included in Table 3.6. A copy of the interview questionnaire used in the data-gathering effort is included as Appendix B.

## II. BACKGROUND

### A. HISTORY OF THE COMMERCIAL ACTIVITIES PROGRAM

The issue of determining which functions should be performed by the private sector and which ones are more appropriately performed by the government first surfaced following World War I. In 1932, a special committee was established by the House of Representatives to determine which, if any, of the so-called "commercial" functions assumed by the Government during the war should be continued. In 1933, the committee recommended termination of many of these functions within the Government. [Ref. 6]

After World War II, the issue resurfaced as Congressional committees again focused on commercial functions that were carried over as governmental activities after the war years. The general conclusions of numerous Congressional studies was that the Government was involved in many unnecessary and nonessential competitive activities and that efforts should be made to discontinue activities which could be provided with 'reasonable convenience and fair and reasonable prices' by the private sector. [Ref. 6:p. 3]

This area of governmental policy continued to be a topic of interest and discussion on into the Eisenhower years. President Eisenhower addressed the subject in his Budget address in which he stated:

This budget marks the beginning of a movement to shift to ...private enterprise Federal activities which can be more appropriately and more efficiently carried on that way.  
[Ref. 6:p. 3]

Thus began the first in a series of official government pronouncements regarding the performance of commercial functions in the Federal Government.

In 1955, the first written policy concerning commercial functions was promulgated in the issuance of Bureau of the Budget (now the Office of Management and Budget) Bulletin 55-4. In part, this bulletin said that:

It is the general policy of the administration that the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels. Exceptions to this policy shall be made by the head of an agency only where it is clearly demonstrated in each case that it is not in the public interest to procure such products or services from private enterprise. [Ref. 6:p. 3]

This Bulletin marked the initial stages of the Commercial Activities program and was the forerunner of OMB Circular A-76. However, a significant difference existed in the philosophy expressed in BOB Bulletin 55-4 and later iterations of the CA program that emerged in OMB Circular A-76. The key phrase in the BOB Bulletin was "the federal government will not start or carry on any commercial activity...if such product or service can be procured from private enterprise." In essence, the Bulletin banned competition with private enterprise and required reliance on the private sector for the provision of commercial functions. This notion of "noncompetition" permeated Congressional discussions over the next several years, beginning with Senator McClellan's urging of Congress to go

on record "...in favor of a definite policy on noncompetition with private industry in the production of goods and the securing of necessary services." (Ref. 2:p. 5) In fact, during this timeframe there was some movement to institutionalize the policy by introducing legislation that would prohibit government competition with the private sector.

Although official policy in the fifties favored the shift to commercial sources for performing certain operations and the notion of noncompetition was espoused, little actual movement of functions to private sources occurred. In 1959, the Bulletin was republished with a revision defining those circumstances which would justify retention of services in-house. One such exception to privatization that had a significant impact on the future evolution of the CA program was cost. However, the language in the Bulletin (55-4) still "...directed that 'cost should not usually be the deciding factor in determining whether to continue the operation as a direct Government operation.'"

[Ref. 7:p. 25]

In 1966, the BOB Bulletin was institutionalized in Bureau of the Budget Circular A-76.

This revision, in addition to institutionalizing the policy, identified five circumstances under which an exception to the basic premise could be authorized. Cost was one of the five. However, while in the 1959 edition the cost differential had to be 'substantial and disproportionately large,' the 1966 Circular liberalized the language by stating the function can be retained if

dealing with a commercial source 'will result in higher cost to the Government'. [Ref. 2:p. 6]

Although cost was an allowed exception under the 1966 policy, no specific cost comparison process was delineated in the circular. Therefore, methods were not uniform in calculating cost differentials and the practice of justifying the retention of functions in-house on the premise of a cost exception was not uncommon.

In October 1976, Transmittal Memorandum Number 2 (TM-2) revised BOB A-76 "by raising the cost factor for civil service retirement to be used in cost comparisons from 7% to 24.7% of basic pay." [Ref. 7:p. 31] This was the first in several revisions to the calculation of the civil service retirement benefit and continues to be an area of controversy in the cost comparison process. In June 1977, Transmittal Memorandum Number 3 (TM-3) "re-emphasized the basic policy contained in BOB A-76 and reduced the retirement cost factor from 24.7% to 14.1% of basic pay." [Ref. 7:p. 31] About this time, Congress in a demonstration of legislative control over the procurement 'purse strings,' ...displayed their concern for the Commercial or Industrial Type Activities (CITA, later CA) program, in the FY 1978 Defense Appropriation Authorization Act. This Act required OSD, in conjunction with OMB, to submit in detail, all CITA policy changes since 1967. It also prohibited any further conversions to contract unless the policies in effect prior to June 30, 1976 were followed. The net effect of this action was to negate TM-2 and TM-3 causing the retirement cost factor to revert to a pre-1976 level of 7% of basic pay. [Ref. 7:p. 33]

Since that time, the rate used for the retirement benefit has been revised twice more to its present level of 27.05%. This rate has just changed as of March 1988 to account for the change in the retirement system for federal employees hired since December 31, 1983. [Ref. 8] These employees are covered by social security, and the Congress has been considering alternative retirement programs for them. The retirement cost factor has continued to fluctuate and remains an area of controversy in the cost comparison process. The debate over this element of the cost comparison study is likely to continue in the future as the new retirement system is implemented.

In 1978, GAO,

...issued perhaps its most comprehensive report to date on the national make-or-buy policy. The report noted that Federal agencies, to include all branches of DOD, experienced difficulty first, in ascertaining when to conduct a comparative cost analysis; and second, how to determine a reliable, accurate, and justifiable estimate of in-house costs. In their Report to Congress, GAO also made the following observations:

1. Complete and accurate in-house cost data is not readily available.
2. OMB Circular A-76 does not generally require cost comparisons to support contracting out decisions.
3. OMB Circular A-76 does not require cost comparisons on activities already contracted out to assure their continued cost effectiveness.
4. Uncertainty exists concerning the stability and accuracy of the Government retirement cost factor.

5. Uncertainty exists on whether in-house costs should be determined on an incremental or fully allocated basis.

6. Cost comparisons lack credibility in some cases because they are often prepared by personnel who are unqualified or would be affected by actions.

7. Required reviews of the commercial or industrial activities are far behind schedule. [Ref. 7:pp. 34-35]

These findings shaped the future evolution of the program and surfaced issues that still are not resolved.

The year 1979 marks a sharp change in the philosophy of the Commercial Activities program. The basic premise of reliance on the private sector for commercial functions still remained, but the concept of "noncompetition" was reversed. The emphasis shifted from relying on the private sector to relying on the private sector if it is cost effective to do so. [Ref. 2] In September 1984, Joseph B. Wright, Deputy Director of OMB, testified before a House Subcommittee that "...for the first time, the basic concept of A-76 began to change to recognize the equity and value of having Federal workers compete for the jobs they were holding." [Ref. 2:p. 8]

Accompanying the revised circular was a comprehensive Cost Comparison Handbook which provided detailed instructions for developing cost comparisons of estimated in-house and contract costs. The Cost Comparison Handbook set forth standard cost factors and was intended to provide a uniform methodology for making cost comparisons. [Ref. 6:p. 4]

"It was a desire to simplify the cost comparison process and get the program moving again that led to the 1983 version of A-76." [Ref. 2:p. 8] In essence,

...cost comparison methodology was changed from the complex full cost method to a simpler incremental approach. It shortened the cost comparison form from 32 to 17 lines. Many of the complex cost computations that were often contested were either eliminated or replaced by standard cost factors. [Ref. 9:p. 24]

This revision represents the most current version of the CA program philosophy and methodology. An update was issued via Transmittal Memorandum No. 1, dated 12 August 1985, but no significant changes in philosophy or methodology resulted from this revision. In conjunction with the Circular, there is also a Supplement to A-76 that implements the policy in it by,

...establishing procedures for determining whether commercial activities should be operated under contract with commercial sources or in-house using government facilities and personnel. The supplement is divided into four parts: policy implementation, writing and administering performance work statements (PWS), management study guide, and the cost comparison handbook. [Ref. 10:p. 7]

Thus, the structural framework for deciding who should perform certain governmental operations had been established.

Since 1983, the CA program has remained a topic of controversy.

Concern about budgetary implications is only one of many raised in the debate on contracting out. The debate has continued through successive revisions of the federal policy and has centered on such issues as fairness, quality, and accountability. [Ref. 11:p. 10]

In the early 1980s, then Secretary of Defense Caspar Weinberger and his Deputy Frank Carlucci established a series of budgetary initiatives that stressed the need for effectiveness and efficiencies in the Defense Department. On 6 January 1986, Secretary of the Navy, John Lehman issued a memorandum directing the Chief of Naval Operations and Commandant of the Marine Corps to institute programs to more efficiently and effectively use civilian personnel within specified end strengths. Additionally, the memorandum stressed more vigorous implementation of efficiency reviews, productivity enhancement programs and the Commercial Activities program.

Most recently, Executive Order 12615 of November 19, 1987 orders a step-up in the identification and conduct of cost comparison studies for commercial activity functions. Among other things, it mandates the identification by April 29, 1988 of all commercial activities currently performed by the government. It also requires the scheduling by June 30, 1988 of all commercial activities for study in accordance with the procedures of OMB Circular A-76 and the conduct of annual studies of "not less than 3% of the department or agency's total civilian population, until all identified potential commercial activities have been studied." [Ref. 12:p. 1] Concurrent with the Executive Branch's attempts to accelerate implementation of the CA program has been Congressional movement to slow the program down. Under the

so-called Nichols amendment, championed by Democratic Representative Bill Nichols of Alabama, the authority for contracting out commercial activities is transferred for two years from DOD officials to local base commanders. [Ref. 13:]

Also coming out of a House and Senate conference was a requirement permanently banning the contracting out of security guard services at military installations. Contract firefighting had already been prohibited at installations. And Congress, while it did not pass a measure banning maintenance by contract at Army depots, did chide the Army for relegating too many 'mission-essential' jobs to contract workers and required a report from the defense secretary by May on how he plans to correct the situation. [Ref. 13:p. 20]

This policy tug-of-war between Congress and President Reagan will likely continue until the end of the President's term, when a new administration will formulate the future direction of the Commercial Activities program.

Controversy seems to remain an integral part of the history of CA program implementation. In the next section, a general description of the CA process and an overview of the cost comparison process is presented.

#### B. PROGRAM DESCRIPTION AND COST COMPARISON OVERVIEW

The process involved in implementing the policy outlined in OMB Circular A-76 consists of basically four phases: inventory, management review, cost comparison, and implementation of the results of the cost comparison. The inventory phase involves the identification of Navy activities ashore that can be performed by commercial

sources. This includes all those functions that are not excluded because they are "governmental in nature" as outlined previously.

The management review phase of program implementation involves systematic examination and analysis by the activity to identify any special circumstances that would preclude performance of the function by a commercial source.

The process is initiated when the local command submits a review format via the chain of command to OPNAV (OP-443) with certain data specified by OPNAVINST 4860.6C. The data are examined and a decision is made whether to conduct a cost study. During the review process, OPNAV (OP-443) examines each function to determine whether it should be retained in-house for national defense reasons. Valid reasons for national defense exemptions are detailed in OPNAVINST 4860.6C and include mobilization and contingency requirements, military training requirements, maintaining the Navy's sea/shore rotation base and depot and intermediate level maintenance requirements. [Ref. 10:p. 11]

Other exemptions allowed on a case-by-case basis include those for core logistics functions and patient care at DOD hospitals. [Ref. 1] Once a decision has been made to conduct the cost comparison, the third and most complex phase of program implementation begins.

The purpose of the cost comparison phase is to determine if it is more economical to perform the function in-house using government employees or to contract with a commercial firm. The cost study itself consists of several different steps beginning with the development of the Performance Work Statement (PWS). The task analysis involved in the development of the PWS must identify and quantify the output

generated by the function. This represents one of the most difficult tasks involved in the CA process and is critical to the ultimate success of the entire cost comparison study. The PWS forms the basis of both the government's and commercial sources' cost estimations/bids and therefore must accurately reflect what is desired in terms of quality and performance. "Insofar as possible, the Statement of Work (PWS) is meant to specify work only in terms of its outcome, rather than in terms of the procedures used to achieve that outcome." [Ref. 14:p. 4] Procedural matters are left to the discretion of the "competing activities" in order to allow maximum flexibility for achieving efficiencies.

Recognizing the importance of the PWS and to assist field activities, standard or generic PWSs for the various functional areas have been developed. Completed DOD generic PWSs for CA functional areas are being collected by the Defense Logistics Studies Information Exchange (DLSIE), Fort Lee, VA for dissemination upon request of DOD components and other Federal agencies. [Ref. 1:pp. 4-14 and 4-15]

In addition to specification of the work to be performed, or the outcome, the PWS also includes a section known as the Performance Requirements Summary (PRS) which stipulates the performance standards or quality levels that must be met. These levels represent the amount of deviation from "perfect" work allowed before the government will make monetary assessments against a contractor's monthly billings for non-compliance, should the function be contracted out. Therefore, this section of the PWS represents those functions or outcomes of the operation that the government

deems most critical to performance success. Included in the PRS, in addition to the Acceptable Quality Level (AQL), is a deduction percentage which approximates the level of importance that the activity assigns to each of the performance measures. These performance quality standards "are designed to be objectively measurable, and quality control is part of the contractor's responsibility." [Ref. 14:p. 5] Should the function be contracted out, the PRS will form the basis of both the contractor's Quality Control program and the government's Quality Assurance program. The Quality Assurance program is implemented using government employees known as Quality Assurance Evaluators (QAEs) or sometimes called Contract Compliance Representatives, and consists of conducting regular surveillance to ensure contract (PWS) compliance.

While a formal quality assurance program is not required for government performance, the MEO must provide a capability for evaluating and for clearly documenting government performance to the standards set by the PWS. [Ref. 1:p. 4-21]

The next step in the CA process is the conduct of a management study/review with respect to the stated tasks of the PWS. The objective of this review is to ensure that the,

...in-house work force is organized and staffed as efficiently and effectively as possible, that the structure of jobs and positions is considered, and that internal operating procedures foster efficient production and proper performance of services (within current resources). [Ref. 13:p. 13]

Once this review has been conducted, the organization is restructured into what is termed as the Most Efficient Organization or MEO.

Concurrent with the development of the MEO is the preparation of the in-house cost estimate. Detailed guidance for preparation of this estimate is contained in the Cost Comparison Handbook. Category and line-by-line computational techniques are included in the handbook and include guidance on such factors as inflation, personnel costs, materials and supplies, depreciation, overhead, contract administration, conversion costs, etc. Of particular note in this process, is the fact that if a function has been identified as a commercial activity, it represents a decision that the function does not require any military positions. (If the CA function was required for sea/shore rotation purposes, it would have been eligible for exemption in the previous step.) Therefore, any military positions in the function under study "...shall be converted to civilian positions for cost comparison purposes." [Ref. 1:p. 4-19] The cost estimate developed in conjunction with the MEO is for an "all civilian" in-house operation.

Based upon the requirements of the PWS, the MEO is costed out using the guidance provided in the Cost Comparison Handbook and the estimate is presented to the Contracting Officer in a sealed bid. The government's bid for providing the product or service is compared to that of

the lowest, competent and responsive private bidder and a decision is made to either retain the function in-house, thus implementing the MEO, or to contract out the function. Implementation of the results of the cost comparison process is the final phase of the CA program as it is formally outlined in written policy and guidance.

The CA program is defined in pre-award terms and provides little formal guidance for transition to the MEO or to the contractor. Nor does the formal guidance concern itself with the post-award process of contract administration, surveillance and performance except to estimate CA personnel cost. As noted by questionnaire respondents, if the program is viewed from a transaction cost perspective, post-award transaction costs in excess of those anticipated by the pre-award cost comparison process are often ignored. It is precisely these areas or transactions that often form the basis for much of the debate and controversy that surround the Commercial Activities program. The next section outlines some of the practical issues that have arisen as a result of the program's implicit assumption that pre-award estimates accurately reflect all post-award costs, particularly in those instances where the cost decision has been to contract out.

#### C. PRACTICAL ISSUES

When the ultimate decision of the cost comparison process has been to contract out, debate occurs at the local

command level over both the prudence and economy of that decision. Where contracting out advocates point to potential savings that can be realized by such a decision, opponents focus on the post-award consequences of it, such as possible deterioration in quality of performance, loss of managerial control and flexibility, morale considerations and additional costs that are either ignored or underestimated in the pre-award cost estimates. Additionally, there is debate on the reliability of a contractor's performance during times of mobilization and discussion of problems with establishing accountability, even during peacetime. Proponents of contracting out focus on the fact that, "private markets are strengthened when the government refrains from performing commercial activities itself" [Ref. 11:p. 11], contending that many of the "quality" or performance problems are caused by poorly written specifications and/or a substandard quality surveillance program. Navy managers of the program point to the lack of government experience in this type of effort and poorly written contracts early on in the program as "the root cause of most of the contractual problems experienced." [Ref. 2:p. 44]

Little formal research has been conducted to substantiate either side's claims of benefits or costs and a number of issues have therefore not been sufficiently addressed. The post-award results of the CA process are rather loosely

monitored and there is no formal accounting system that captures litigation costs, conversion costs, contract administration costs in excess of that allowed for in the cost comparison process, quality or substandard performance costs, or the cost of contingency operations.

Other issues have arisen as a result of implementing contractor operations. For instance, there is no formal guidance to commands on how to accomplish the "contracted out" function in the event of contractor default or bankruptcy or how to manage resource/fund cuts in the event of reduced budgets for those functions that are now performed commercially (particularly in the case of umbrella-type contracts where all base support operations are contracted out). These issues are likely to increase in importance as the Department of Defense enters a resource-constrained era and "hidden" costs that were previously absorbed by the activities can no longer be sustained. The absence of a formal monitoring system to address post-award costs ensures that the debate over contracting out will continue. More importantly, it leaves a gap in the financial control of these costs and the problem where management is not alerted to a significant resource allocation issue. Later chapters of this thesis address these issues and present some findings on post-award results.

The next section presents a statistical overview of the CA program as it exists in the Navy and the decisions that resulted from the cost comparison studies conducted thus far.

#### D. STATISTICAL OVERVIEW

In the period between Fiscal Year (FY) 1979 and FY 1987, a total of 823 CA cost studies were conducted in the Department of the Navy, involving approximately 22,000 positions. The net total program savings realized are estimated to equal \$495.2 million. [Ref. 15] Of the 823, about 58% of the studies resulted in continued in-house operation and the other 42% converted to contract. Of the 101 studies that involved either food service or storage and warehousing operations, or both, 52% of the functions remained in-house and 48% were converted to commercial sources. For storage and warehousing and/or food service operations on the West Coast, 52% of the 27 activities converted to a contractor operation and 48% remained government operations.

The 14 West Coast activities that converted to contract and are the subject of this research involve approximately 1492 positions. Two activities involved single function food service operation contracts (S713), six involved single function storage and warehousing operations (T801) and six were multi-function umbrella or base support type contracts that included either a food service operation, a storage and

warehousing operation or both. The in-house MEO bids exceeded contractor bids on contracted out functions with total cost differences ranging from 1.105% to 57.175% for these 14 activities. [Ref. 15] The contractor bids included an estimate of the contract administration costs (normally ranging from 4-8% of the MEO bid), but excluded the 10% of MEO personnel costs that are added before making the actual contract out decision. The 57.175% differential occurred at an activity that had no area Department of Labor wage determination for the type of service being contracted for. For the follow-on contract at this activity, the Department of Labor wage determination was established and the contract increased significantly in price (i.e., by 83.9%), although it was still below the in-house MEO cost. The Service Contract Act of 1965 provides for the establishment of minimum wages, benefits and working conditions for service contract employees. This is implemented by a Department of Labor wage rate determination for a specific geographical area. The wage determination serves as a bottom limit for the contractor on employee wages and in certain cases reduces some of the contractor's cost flexibility in contract competition. The average cost differential between in-house MEO bids and contractor bids in this research was 17.66%, with a total aggregate difference across all fourteen activities of 12.66%. Table 3.6 presents cost differentials by individual command.

For a comprehensive overview of CA program statistics, see Appendix A. A detailed presentation of data on the 14 activities involved in this study is included in Chapter III, along with a discussion of the research methodology and findings.

### III. METHODOLOGY AND DATA PRESENTATION

This chapter presents the criteria used to determine the sample, as well as an outline of the research methodology used in conducting the study. Additionally, a presentation of the demographics of the sample and the data as it was encountered during the course of the research are included. Data analysis and the identification of policy issues revealed by the data are covered in Chapter IV.

#### A. SAMPLE SELECTION

To determine the population of CA cost comparisons conducted in the Department of the Navy, a computer print-out was obtained from the data base maintained by the Chief of Naval Operations (OPNAV-443). This listing, dated 27 November 1987, was sorted by "Primary Function Studied." Each functional area is normally coded by an alpha-numeric code that indicates the basic operation being studied. A total of 823 cost comparisons had been conducted during the period from October 1978 (when the first formal cost comparisons were conducted) to November 1987. A manual review was conducted on this population listing to select those studies that were assigned a functional code of either S713 (Food Service operations) or T801 (Storage and Warehousing operations) as either the "Primary Function

"Studied" or as the "Secondary Function Code." Multi-function or the umbrella-type contracts are coded using one primary function code (usually corresponding to the largest operation) with all other operations listed as secondary function codes. During the manual review, it was determined that 101 cost comparisons had been conducted on Food Service operations, Storage and Warehousing operations, or both. Due to time constraints and problems with accessibility, we focused our data gathering efforts on those Navy activities located on the West Coast of the United States or Hawaii. There were 27 activities identified on the computer listing that involved studies of the supply operations of interest. Of these 27, 14 operations had been contracted out. Since the research was primarily concerned with the "hidden costs" of contracting out, it was these 14 activities that formed the basis of our study.

In addition to the responses provided by the 14 activities, additional data was gathered in phone interviews with CA staff personnel at the Chief of Naval Operations (OPNAV-443); Commander, Naval Air Force, Pacific Fleet (COMNAVAIRPAC Code 52); Commander, Naval Supply Systems Command (NAVSUP Code 0123B); and Commander, Naval Telecommunications Command (COMNAVTELCOM Code N112A). Except for OPNAV-443, these commands represent some of the major claimants for the 14 activities that were studied.

## B. METHODOLOGY

Once the 14 activities of interest had been identified, phone interviews with key contract administration personnel were conducted. Key personnel included the Service Contract Managers (SCMs), Contracting Officer Technical Representatives (COTRs), and in some cases, Contracting Officers (KOs) and Comptrollers (where appropriate). Key personnel were contacted at 12 of the 14 commands identified. At one command the contracted out operation could not be identified. Both the Supply Officer and Comptroller at this command maintained that no function had been contracted out there. Since the operation, as it was identified on the computer listing, involved only four positions, it was decided that the additional time needed to "find" the operation was not justified. One other activity could not be contacted and is located in Hawaii.

After establishing contact with an activity, outlining the purpose of our research and assuring anonymity, some basic background information about the contract involved was obtained from the contacted commands. A five page interview questionnaire was used as the primary means of gathering data and was mailed to the activities after the initial contact had been established. 75% of the activities contacted provided a response to the questionnaire. The interview questionnaire is included in Appendix B. The information provided in response to the questionnaire is

summarized in subsequent sections of this chapter. Follow-on phone interviews were conducted with respondents to obtain clarification/amplification on responses where appropriate.

Informal interviews were also conducted with the major claimants to identify CA issues that had surfaced in conjunction with the administration of contracts at their level. Additionally, informal interviews with OPNAV-443 were used as a means of clarifying program and policy issues that arose in the course of the research, as well as to clarify statistical information provided by them.

Concurrent with the data gathering effort, an extensive literature review was also conducted. Several audits on CA implementation and post-award results were used for comparison with the results of our data. Additionally, these audits, along with other research and publications were used as sources of amplifying information on the history of the CA program, and for theoretical background and information on the privatization issue. Finally, the Cost Comparison Handbook and Navy instructions pertaining to the implementation of the CA program were also examined.

#### C. DEMOGRAPHICS OF THE SAMPLE

In order to preserve the anonymity of the sample, a numerical designation for each activity labels individual command data. Demographic data was broken down by claimant, year of the original cost study, number of civilian

positions involved, dollar value of contractor/MEO bids and geographic region involved. As the tables following this section depict, the sample represented a diverse cross-section of claimancies, contract dollar values, number of positions involved and year of study. Tables are the primary means of presenting demographic information relating to the sample composition and immediately follow this section. Tables 3.1 and 3.6 present individual command data. Tables 3.2 through 3.5 summarize information from Table 3.1 across commands. Table 3.6 specifically deals with the 14 commands that comprised the sample and depicts bid differentials where the contractor bid was less than the MEO bid. For comparative purposes, Table 3.7 presents the same data as that presented in 3.6 for those 13 commands of the original 27 that remained in-house. Table 3.8 summarizes information related to Table 3.6.

#### D. RESULTS OF DATA COLLECTION

Data gathering was conducted primarily by two methods:

1. Formal interview/written responses using the interview questionnaire included in Appendix B.
2. Informal interviews with questionnaire respondents and personnel involved in the CA program implementation process at headquarters and the major claimant level.

In addition to these two methods, a literature review was a secondary means of substantiating results of our data gathering effort. This section details the results of this effort, differentiating each by the research method used.

TABLE 3.1

## BREAKDOWN BY CLAIMANT, YR OF ORIGINAL STUDY AND POSITIONS INVOLVED

<u>CMD</u>	<u>CLAIMANT</u>	<u>YR OF STUDY</u>	<u># OF POSITIONS</u>
1	CINCPACFLT	FY 1987	400
2	CINCPACFLT	FY 1986	152
3	CINCPACFLT	FY 1986	269
4*	NAVFAC	FY 1985	4
5	CINCPACFLT	FY 1985	91
6*	CINCPACFLT	FY 1985	115
7	SPAWAR	FY 1983	9
8	SPAWAR	FY 1983	253
9	NAVSUP	FY 1982	26
10	NAVSUP	FY 1982	9
11	NAVSUP	FY 1982	6
12	NAVSUP	FY 1982	36
13	TELCOM	FY 1982	7
14	CINCPACFLT	FY 1981	49

\* unable to contact these commands

Source: Navy Commercial Activities (CA) Program Report, FYs 1979-1987, dtd 02 Nov 87 (OPNAV-443)

TABLE 3.2  
NUMBER OF COMMANDS IN SAMPLE BY CLAIMANT

<u>CINCPACFLT</u>	<u>NAVFAC</u>	<u>NAVSUP</u>	<u>TELCOM</u>	<u>SPAWAR</u>
6	1	4	1	2

TABLE 3.3  
NUMBER OF COMMANDS IN SAMPLE BY YEAR OF STUDY\*

<u>FY81</u>	<u>FY82</u>	<u>FY83</u>	<u>FY84</u>	<u>FY85</u>	<u>FY86</u>	<u>FY87</u>
1	5	2	0	3	2	1

\*There were no studies in the sample in the FYs 79-80

Source: Navy Commercial Activities (CA) Report, FYs 1979-1987, dtd 02 Nov 87 (OPNAV-443)

TABLE 3.4  
SUMMARY OF STUDIES BY NUMBER OF POSITIONS INVOLVED

<u>BELOW 10</u>	<u>11-50</u>	<u>51-149</u>	<u>150-249</u>	<u>OVER 250</u>
5	3	2	1	3

Source: Navy Commercial Activities (CA) Report, FYs 1979-1987, dtd 02 Nov 87 (OPNAV-443)

TABLE 3.5  
NUMBER OF COMMANDS IN SAMPLE BY STATE

<u>CALIFORNIA</u>	<u>WASHINGTON</u>	<u>HAWAII</u>	<u>NEVADA</u>
8	2	3	1

TABLE 3.6

BREAKDOWN BY MEO AND CONTRACTOR BID AMOUNT (IN \$000)  
(WEST COAST FUNCTIONS THAT WERE CONTRACTED OUT)\*

<u>CMD</u>	<u>MEO BID</u>	<u>CONTRACT BID</u>	<u>% DIFFERENCE</u>
1	\$64,312	\$58,650	8.804%
2	\$30,228	\$25,797	14.659%
3	\$46,379	\$40,024	13.702%
4	\$ 5,872	\$ 4,968	15.395%
5	\$13,276	\$ 9,408	29.135%
6	\$23,413	\$21,645	7.551%
7	\$ 1,106	\$ 887	19.801%
8	\$17,360	\$15,336	11.486%
9	\$ 3,033	\$ 2,245	25.981%
10	\$ 892	\$ 698	21.749%
11	\$ 1,095	\$ 1,005	8.219%
12	\$ 4,027	\$ 3,520	12.590%
13	\$ 439	\$ 188	57.175%
14	\$ 2,262	\$ 2,237	1.105%

\* Breakdown is for the 14 sample commands (where the contractor bid was less than the MEO bid). Contractor bids do not include 10% MEO labor cost differential that is added prior to making a contracting out decision.

Source: Navy Commercial Activities (CA) Report, FYs 1979-1987, dtd 02 Nov 87 (OPNAV-443)

TABLE 3.7

BREAKDOWN BY MEO AND CONTRACTOR BID AMOUNT (IN \$000)  
 (WEST COAST FUNCTIONS THAT REMAINED IN-HOUSE)\*

<u>CMD</u>	<u>MEO BID</u>	<u>CONTRACT BID</u>	<u>% DIFFERENCE</u>
15	\$ 154	\$ 325	+ 111.039%
16	\$ 748	\$ 689	- 7.888%
17	\$ -----**		
18	\$ 2,917	\$ 4,877	+ 67.192%
19	\$ 1,648	\$ 1,501	- 8.919%
20	\$ 1,320	\$ 2,568	+ 94.545%
21	\$ -----**		
22	\$ 2,630	\$ 2,430	- 7.605%
23	\$12,571	\$11,437	- 9.021%
24	\$ 571	\$ 637	+ 11.559%
25	\$ -----**		
26	\$18,716	\$19,269	+ 2.955%
27	\$ -----**		

\* Breakdown is for those commands excluded from the sample because they remained in-house. Negative differentials indicate that the contractor bid was lower than the MEO bid before the 10% MEO labor cost was added on (i.e., the contractor bid was higher once the required labor differential was included).

\*\* Cost data not available for these commands

TABLE 3.8  
SUMMARY BY DOLLAR VALUE OF THE CONTRACT (000)

<u>UNDER 1000</u>	<u>1001-5000</u>	<u>5001-20,000</u>	<u>OVER 20,000</u>
3	5	2	4

1. Questionnaire Results

Overall, respondents indicated that the contractor had performed satisfactorily since contract award. In fact, all noted satisfaction with the performance of the current contractor. Two respondents indicated that previous contractors had experienced performance problems. One respondent stated that the poorly performing contractor was held onboard through the third option year despite poor performance because there were no other options for maintaining the operation (i.e., no government employees left to assume the operation during the resolicitation process). This contractor subsequently lost the resolicitation bid. The second activity indicated that the first contractor was terminated by not exercising the option year. In all, four commands indicated they were on follow-on contracts.

Performance assessments were made primarily by using observation (in all cases) and the results of Quality Assurance inspections (in all but one of the cases). Additionally, 56% indicated that performance was evaluated using external inspection results and 78% said customer

satisfaction measures were used. Although formal measurement programs were used to assess performance in a majority of the cases, only three commands actually provided performance statistics in response to Question #3 of the interview questionnaire that compared pre-award and post-award performance. Examination of the statistics provided by these three commands showed a slight (but not significant) decline in performance at one command, a small decline at another (but still acceptable under the terms of the contract), and no change in performance at the third. The fact that only three commands provided objective data to substantiate their assessments of satisfactory performance by the contractor may be an indication of the need for better control systems to monitor these areas, or the need for better data base management to access the information.

A majority (56%) of the commands queried had taken deductions for substandard performance despite acceptable performance overall. Four commands provided the actual cumulative dollar amount of deductions taken and in all cases the amount was less than 1% of the total contract price. One command indicated that the first contract for the operation did not include a deduction clause, although the current contract now has one incorporated. Table 3.9 presents a frequency distribution of the deductions taken as a percentage of the contract price.

TABLE 3.9

FREQUENCY DISTRIBUTION OF \$ VALUE OF DEDUCTIONS  
AS A PERCENTAGE OF CONTRACT PRICE

<u>0%</u>	<u>.01-.09%</u>	<u>.1-.9%</u>	<u>&gt; or = 1%</u>	<u>\$ Value Unknown</u>
4	2	2	0	1

Four commands also indicated that they had issued Contract Discrepancy Reports both in addition to and in support of deductions. Other actions taken by activities related to contractor performance included: contract clarification and amplification (no re-imbursement involved), the notation of sanitation discrepancies for immediate correction, and at one command, a quarterly performance review with the contractor was conducted.

All respondents indicated that the current contractor was experienced in the type of operation they were performing, with approximately 67% having performed similar work for the Navy or Department of Defense previously. About 89% of the respondents indicated that the dollar amount of the original bid had changed during the course of the contract, primarily due to scope of work and procedural changes. Sixty-seven percent indicated that modifications were made to the PWS during the course of the contract. Only two respondents indicated that a claim had been filed against the government on the current contract. A third command noted that a claim had been filed on a

previous contract. One claim filed on the current contract on the contractor's behalf was not upheld so no damages were involved. However, government time and money were used to assemble a litigation package of approximately 20 documents. This included QAE Reports and other substantiating documentation. The other claim on a current contract was upheld and the contractor was paid a nominal award of approximately \$300. The claim that involved a previous contractor was settled by the government in behalf of the contractor for approximately \$30K (primarily due to PWS inadequacies).

Two respondents indicated that a sealed bid was used to award the contract, with two respondents using Small Business Set-aside procedures. However, the majority of the activities used negotiated procurement to make the award. Technical proposals were used in a majority of the awards (56%), with only two commands not using one and the others unsure whether a technical proposal was included as a contract requirement. Only 44% of the activities were directly involved in the pre-award survey before contract award. A pre-award survey is an on-site visit to the prospective contractor's facilities to assess both the financial integrity and technical competence of the company and its personnel.

Responding to the question "Do you feel that the cost comparison process accurately reflects the cost of

contracting out?", only two of those queried responded positively, two did not respond and the remaining five respondents answered "no." About half of the nine respondents felt that the contract administration estimate was too low and this opinion was confirmed by examining the staffing detailed in several of the responses to another question on the questionnaire (Question #10). Those commands that had the most extensive contract administration staff were supported in this staffing by a major claimant that provided substantial pre-award and post-award guidance and that was heavily involved in the implementation process. Chapter IV discusses the policy implications of this staffing decision. Other contract administration costs that were not anticipated included the time involved in contract negotiation and the vehicles required for the Quality Assurance staff.

Another reason for questioning the accuracy of the cost comparison process is the loss of productivity on the part of remaining government employees that is not accounted for. Respondents noted that many remaining government employees suffered morale problems and were anxious over the possibility of losing their jobs. Also many workers who were displaced by the contractor were placed in other government positions of lower status and pay (once saved pay provisions run out). Respondents felt the anxieties and morale issues that appeared subsequent to contracting out

impacted on productivity. In addition to morale costs, respondents noted that post-award litigation costs are not accounted for. Although only two sample activities had actually been involved in litigation proceedings on the current contract, this could be a significant cost in the aggregate.

A summary of the responses to non-narrative questions on the interview questionnaire are included in Table 3.10.

## 2. Informal Interview Results

Informal information was obtained primarily from representatives of the major claimants responsible for the sample activities, as well as from OPNAV-443 on policy clarification issues. However, some informal information also was obtained from questionnaire respondents in background discussions conducted during the course of initial and follow-up interviews.

### a. Sample Respondents

Some of the issues surfaced by sample respondents were the results of "lessons learned" during the course of CA program implementation. Several respondents stressed the importance of both command involvement and positive government attitude toward the incoming contractor as crucial to the success of a contractor operation. One respondent indicated that a negative attitude by management contributed to the failure of an initial contractor,

TABLE 3.10  
SUMMARY OF QUESTIONNAIRE RESPONSES

<u>QUESTION*</u>	<u>YES</u>	<u>NO</u>	<u>NO RESPONSE</u>
1. Satisfied w/current contractor performance?	9	0	0
4. Deductions taken for substandard performance?	5	4	0
7. Litigation/claims filed against contract?	2	7	0
12. Damage to government facilities?	1	8	0
13. First contractor performing function?	5	4	0
15. Dollar amount of original bid changed?	8	1	0
17. Pre-award survey conducted by command?	4	5	0
19. Modifications to PWS experienced?	6	3	0
20. Technical proposal used in solicitation?	5	2	2
21. Contractor experienced in operation?	9	0	0
23. Cost comparison accurately reflects actual cost of contract?	2	5	2

\* Question numbers correspond to the question number on the actual questionnaire (included in Appendix B)

coupled with a poorly written Performance Work Statement. Another respondent cited strong command support and involvement in the entire implementation process as critical to the success of their transition. Command meetings with all affected Department Heads about 60-90 days prior to the transition to a contractor operation were used to highlight contract specifications and identify possible problem areas.

The two commands that experienced prior contractor performance problems noted that a vaguely written, unenforceable PWS contributed to contractor failure. In one case, poor performance was tolerated because there was no deduction clause in the contract and, therefore, no way of enforcing standards. This same command extended the "poor performer" through the next option year because they lacked alternative means of sustaining the operation while a new contractor was solicited. The other command noted that the contract was written to reimburse the contractor based upon the volume of transactions performed. Since the volume of work stipulated in the contract was much greater than the actual volume of work required of the contractor, the contractor was unable to meet fixed expenses and, therefore, filed a claim against the government which was subsequently settled by a reimbursement of about \$30K.

Several respondents noted that a major contributor to contractors' success was their ability to meet workload changes through flexibility in manning levels

and simpler hiring practices than those employed by the government. However, in complex operations where the entire scope of the mission may change (not just workload volume), it was noted that contracting out reduces government flexibility. Such changes must be negotiated and the contract modified to incorporate major mission shifts (often resulting in higher contract costs). In general, contract specifications are established well in advance of actual performance and, particularly in the storage and warehousing operations, the scope can change significantly over time. Another aspect of this inflexibility is that one-time special requirements (often dictated by critical, operational taskings) cannot be performed quickly because additional contract negotiations must be conducted and reimbursement agreed to prior to the contractor assuming such taskings.

Several respondents noted that they allowed a small amount of substandard performance in the early stages of the contract without assessing deductions in order to enhance working relations between the government and the contractor, and to allow for a normal learning curve. Once the initial transition period passed, however, all indicated that an adequate and competent contract administration staff was critical to contract success. A detailed and complete Quality Assurance Plan in conjunction with a competent QA

staff can ensure that deficient performance is documented and corrected.

In general, the majority of respondents stated that the type of contract should be tailored to the complexity of the operation involved as well as to the need for coordination among base support activities. High levels of coordination are better addressed using the multi-function or umbrella-type contracts, while "stand-alone" operations can be adequately performed using a single function contract. Additionally, many respondents would prefer the use of a "Cost plus Award Fee" contract for those operations of a complex nature and a "Firm Fixed Price" contract for the less complex ones. The primary rationale given for this preference was that the deduction clause represents a negative incentive and is subject to litigation (which requires the maintenance of extensive documentation) while the "award fee" offers the contractor a more positive performance incentive and cannot be litigated (thereby lessening documentation requirements). This type of contract might be consistent with the "leaner" quality assurance staffs specified in the Cost Comparison Handbook guidance. Respondents preferring the Firm Fixed Price contract felt that it minimized the potential for inflated contractor costs charged to the government.

Finally, nearly all respondents indicated that the management review process of the CA program (resulting

in the MEO) was beneficial in achieving greater command efficiencies even without a cost comparison. However, a few respondents noted that this might result in MEOs that are "so lean" that they are unable to meet PWS requirements. In general, respondents indicated that they felt the CA program was saving the government money although the extent of the savings are not accurately reflected in the cost comparison process due to unanticipated post-award administrative and other costs.

b. Major and Sub-Claimant Interviews

Informal interviews were conducted with three of the five major or sub-claimant activities involved with administering the CA process at the commands sampled in this study. The purpose of these interviews was to obtain claimant perspective on CA program implementation and contract administration issues occurring at their level. In addition, one major claimant involved in field support and training was also interviewed concerning cost comparison initiatives developed at their level. The activities contacted included COMNAVTELCOM, COMNAVSUPSYSCOM, COMNAVAIRPAC, and CNET. These activities varied considerably in terms of CA program staffing levels and degree of involvement with field activities in the program implementation process (including the provision of guidance and management to them). COMNAVAIRPAC maintains a staff of ten personnel who spend at least 30% of their time on CA and

commissions a small team to assist commands in the cost comparison process as well as the transition from government to commercial operation. COMNAVTELCOM has a CA Program Implementation staff of one (who also performs other duties unrelated to CA) and is considering expanding this staff to a two team staff positioned on the East and West Coast to assist their field activities in the cost comparison and transition process. COMNAVSUPSYSCOM maintains a staff of one person located in the Financial Management Department who is responsible for providing assistance and policy guidance for the entire NAVSUP claimancy, as well as performing other budgetary duties.

Many of the issues surfaced at the major and sub-claimant levels mirrored the concerns voiced by their field activities. In addition to these issues, however, there were also several concerns that involved implementation and management of the CA program at a system or type commander level, particularly in the budget process. One major problem of immediate concern to claimants administering numerous multi-function contracts was the problem of managing budget execution during times of funding cuts. Flexibility is greatly reduced when the entire base support function is provided by commercial sources under a contract that is legally binding. While renegotiation of the contract is a possible means for reducing the contract

cost, the renegotiation process itself is costly and time-consuming. Additionally, in a CA operation performed in-house by government employees, management can directly reduce costs by merely eliminating a number of positions. In a contractor operation, government management is constrained to the reduction of contract requirements in the hope that such a reduction will lead to a decreased contract price. If sufficient cuts cannot be achieved in the support areas for a reduction in contract price, the claimant has no alternative but to take the cuts in the command's operational areas or use funds from a command that does not have contracted out functions to pay for those that do.

Another concern voiced by representatives of the claimancy levels is that Military Personnel, Navy (MP,N) funding that was reduced or eliminated during conversion presents additional budgetary constraints. Since Operations and Maintenance, Navy (O&M,N) funding is locally managed, a reduction has an immediate and direct effect on the activity. Cuts in MPN funds (which are managed centrally) have a less immediate and direct impact on the activity since the cuts are spread over a larger funding base. Thus, resource constraints are more deeply felt by commands that have contracted out their support functions than those who have not.

One issue directly related to the cost comparison process that surfaced at this level, again

concerning budget execution, is that conversion costs are incurred "up-front" as the command goes through the transition but are allocated over a five year period for expensing purposes. Normal accounting practice is to expense these type of costs as they are incurred. By expensing these costs over the extended period, the command does not get credit (i.e., funding) for costs that they actually incur during the transition until several years later, yet, must absorb them upfront.

In addition to funding inadequacies, major and sub-claimants also voiced some concern over the lack of standardization and central policy guidance on the post-award implementation process. Some claimants indicated that the information/direction provided by OPNAV was either not reaching them or was not clear. In fact, this observation seemed valid since this same major claimant's CA program manager complained that 1-2 position reviews were not cost effective and should not be required. This indicated a lack of awareness at the claimant level of OPNAV's position against small (less than 10) position reviews that is clearly outlined in OPNAVNOTE 4860. In general, interviewees at the claimant level indicated a desire for more guidance and training on post-award issues, particularly in contract administration/quality assurance and transition to contractor operations. Some also noted a desire for guidance on handling defaulted contracts in terms

of contingency operations and the resultant costs. Attrition of government personnel (out of the CA program) was cited by several of the claimants as a major problem in maintaining a well-trained, competent contract administration staff. One claimant had solved this problem to some degree by maintaining a closely linked information network within the claimancy and commissioning "implementation" teams to assist in the cost comparison and transition process. Members of this claimancy called their counterparts within the claimancy for advice and information on problems they had encountered in the transition as well as the entire contracting out process (including post-award contract administration problems). During interviews, it became apparent that sample members within this claimancy were aware of the activities and "lessons learned" at other commands under the same type commander.

In general, the claimants indicated that the QA/contract administration staffing allowed by the Cost Comparison Handbook was inadequate to handle complex operations and the multi-function contracts. One claimant stated that multi-function contracts involving entire base support operations should be staffed by approximately 18-20 people who are headed by a Service Contract Manager (SCM) who serves as the command focal point for all commercial operations. All noted an awareness that OPNAV-443 was willing to negotiate concerning additional QA staffing

although some noted that the staffing allowed after negotiation was still generally too low.

One claimant voiced concern that costs increased after the expiration of the basic contract although such increases might also have occurred if the function had remained in-house. A final issue that surfaced at this level concerned the inconsistencies between the estimation techniques used by the government for its employee fringe benefits in the cost comparison process and those used during budget formulation. In general, acceleration rates used in budget formulation range from 16-17% while the cost comparison process currently uses rates in excess of 27% and this rate has historically fluctuated widely. This highlights a continuing concern over the accuracy of the cost of government labor estimates in the cost comparison study.

The areas outlined in these two sub-sections highlight the major concerns and issues surfaced by sample respondents and their major and sub-claimants during the course of informal interviews. The next chapter examines the results of the data gathering effort, analyzes them, and identifies policy issues that require additional attention and resolution.

#### IV. DATA ANALYSIS AND ISSUE IDENTIFICATION

This chapter is divided into three sections. The first section discusses data related to the performance issues of the CA program. The second section addresses unrecorded or underestimated costs in the cost comparison process and the budgetary implications of contracting out functions to the private sector. Lastly, the third section deals with training issues within the CA Program. The analysis in this section is based upon the command data collected as well as from information gathered in the literature review. Conclusions and recommendations based upon the analysis of data are presented in Chapter V.

##### A. PERFORMANCE DATA

The data collected in this research study indicates that activities having contracted out their food service and/or storage and warehousing operations were eventually able to achieve satisfactory performance. However, the period of time required to achieve satisfactory performance, and the means of achieving it, varied across claimancies.

Under extensive pre-award and post-award guidance from COMNAVAIRPAC, the CINCPACFLT activities experienced a relatively short transition period with only minor performance deficiencies. COMNAVAIRPAC uses an "implementation" team fielded from the Type Commander

offices to assist each of their commands undergoing a CA Cost Comparison. This team interacts with the command through each of the successive milestones in the CA implementation process, including the transition to a commercial contractor or the MEO, whichever applies. Use of the team has allowed activities throughout the claimancy to benefit from the experience of those commands that have already undergone the process and helped establish an extensive information network throughout. This network has also helped minimize the effects of attrition out of the claimancy because a solid base of expertise has been constructed.

In contrast to the CINCPACFLT philosophy of providing a centralized system of CA program guidance and assistance to their field activities is the relatively decentralized CA program implementation that exists in the NAVSUP/TELCOM claimancies. Activities undergoing cost comparison studies and conversions in these claimancies need to develop their own strategies and methods for dealing with the issues that inevitably arise during the process. The claimant is not staffed to handle both the routine contract administrative aspects of program implementation at that level and provide centralized guidance and direction. Both NAVSUP and TELCOM maintain a staff of only one person to administer the entire claimancy. However, TELCOM has recently recognized the benefit of providing centralized guidance and assistance to

their field activities and is currently developing a two team approach to assist activities in implementation of the CA process (one team to assist East Coast commands and one for the West Coast).

The data collected during this research study demonstrates the beneficial aspects of centralized claimant guidance. While none of the activities in the CINCPACFLT claimancy experienced any serious performance problems upon the initial transition to a contractor operation, 50% of the NAVSUP activities experienced relatively serious problems with an initial contractor and eventually achieved satisfactory performance only through the more costly process of PWS revision and resolicitation. Under a decentralized philosophy, each command in the claimancy often makes the same mistakes as some of their claimancy counterparts and does not benefit from "lessons learned" by commands that have undergone the process earlier. The resources that must be allocated to solve initial performance problems, revise PWSs, and undergo an additional resolicitation process might be more efficiently used at the headquarters level to man an adequate program implementation staff. This may minimize the instances of litigation as well. In a recent message to major claimants, CNO has acknowledged the benefits of centralized guidance in the CA implementation process and argued "...strongly for vigorous management oversight by claimants and their activities'

commanding officers...." [Ref. 17] In particular, the message noted that:

In general, the most problem-free CA study efforts have resulted when the claimant or subclaimant has actively provided oversight and guidance to its field activities. While the Commanding Officer retains ultimate responsibility for the conduct of CA studies at his or her activity, involvement of the claimant in the process is essential and can yield the following significant benefits:

A. Such involvement reinforces the importance of program execution, encourages command-level involvement in the process, and provides an additional opportunity for review, thereby minimizing the likelihood of major omissions or discrepancies.

B. Support from centralized claimant or subclaimant study teams provides additional benefits. Such support provides an opportunity for intra-claimant sharing of lessons learned, provides field activity personnel with an experienced source of technical assistance for developing the management study, the MEO, and the PWS, and eliminates the need to 'reinvent the wheel' at each activity. [Ref. 17]

Another aspect of the centralized guidance issue surfaced by the contrasting initial performance data of this research, is the complete absence at any level of post-award policy and direction. All respondents in the study expressed a desire for more guidance on the actual conduct of Quality Assurance surveillance such as that provided by Quality Assurance manuals and training. Currently, NAVFAC is the only claimancy that publishes a comprehensive Quality Assurance manual that includes guidance on sampling and QA techniques. An adaptation of such a manual tailored for the other claimancies might be beneficial. Inadequate quality assurance is often cited as the reason for allowing

continued substandard performance in a contracted out operation. For instance, lack of proper documentation by the Quality Assurance Evaluators can seriously undermine government efforts at enforcing contract standards and can jeopardize the government's position in any litigation.

Where quality assurance inspections are inadequate or poorly documented, the government's ability to assess deductions for poor performance is severely limited and performance problems often continue uncorrected. This frequently leaves commands with the sole option of some form of termination and resolicitation to correct poor performance, as happened at two of the commands included in this study. These options are more costly, disruptive and time-consuming. Better initial quality assurance can assist the contractor in correcting problems early on and sometimes can prevent the need to resort to these more costly measures. The Naval Audit Service similarly noted a need for better quality assurance in their "Results of FY 1986 Post-Decision Commercial Activity Reviews at Selected Navy Activities." In this review the auditors noted that,

The commands and customers interviewed were generally satisfied with the performance of the CA functions reviewed but, greater emphasis on quality control and assurance still appeared needed....Without QC and QA, the Government has no assurance that the performance standards in the PWS are being met.

Four of nine contracted CAs reviewed had never implemented a QA plan and a fifth had not done so until approximately 16 months after contract start....One of two commands that were not making deductions indicated that the contract provided for rework of unacceptable services.

This activity's contract, however, called for services which could not be acceptably reperformed (e.g., taxi service) and for which deductions could have been justified. [Ref. 16:p. 7]

These examples highlight the need for a competent, experienced, well-trained cadre of QA personnel. An investment in resources to provide guidance and training on quality assurance will help ensure that this increased level of expertise on the part of the QA staff is achieved. The resources invested to provide this centralized guidance could be at either the CNO or major claimant level. More tailored contract administration guidance would probably occur if the major claimant provided it.

Many sample activities indicated the need for some general guidelines for dealing with such problems as contractor default or bankruptcy. With the dismantling of a government operation, activities that have contracted out their functions are in a particularly precarious situation in the event of a serious contractor performance problem. For example, one sample activity continued to pay a substantially deficient contractor to maintain an operation simply because the command felt there were no other options available to them for the resolicitation period. The cost of any contingency operation that the command might be able to assemble is often more than the command is willing or able to absorb.

In general, the civilian personnel recruiting process necessary to bring onboard temporary government employees to

assist in sustaining an operation is both time-consuming and administratively burdensome. In addition, the impact of personnel moves in such a situation is not limited to the contracted out function. Often, personnel must be detailed from other operations within the command to help sustain the function. This results in impaired operations across several departments/divisions rather than just the operation with the failed contractor. However, the process of bringing a temporary contractor onboard can be equally costly and troublesome, especially if the initial performance problems stemmed from an inadequately written PWS. The respondents in this study felt inadequate to deal with these post-award issues and would benefit from the issuance of some general policy guidelines. OPNAV-443 should issue an instruction on the subject of sustaining service operations in the event of contract termination that would provide some basic guidance and options to activities that have contracted out. Naval Audit Service echoed the need for post-award guidance in their post-decision reviews.

In these reviews it was noted that:

The Government needs to devote more front-end planning to post-decision activities. The process does not end with the cost comparison....If the function is contracted, the activity must have a plan for contract administration and QA....Improved front-end planning will help eliminate back-end problems. [Ref. 16:p. 8]

Another performance-related issue of the CA implementation process is performance definition. In contracted out operations, the adequacy of performance is often

substantially determined by the clarity and completeness of the Performance Work Statement. Defining performance requirements is a complex task, complicated by the fact that all operations change to some degree over time. In simple operations, such as food service operations or janitorial services, most of the changes over time involve workload variation and simple technology changes. The workload variations merely impact on manning levels and require only minor modification to the PWS. Technology changes are generally limited to the introduction of labor-saving devices and do not require extensive restructuring of the organization or intensive retraining efforts. Again, contract modification is minimal.

However, the changes over time that occur in complex operations such as storage and warehousing or multi-function contracts are more complicated and, thus, more difficult to define precisely in a PWS. These operations often experience change in the mix and type of services, as well as changes in workload and technology. Technology changes also are more complex. Often, a change in technology encompasses a shift to automation from a manual process, the development of a more sophisticated computer technology and the incorporation of new or substantially modified procedures and methods of operation. These changes nearly always require a restructuring of the organization and an intensive retraining effort prior to implementation.

Contract modification and renegotiation becomes more difficult and costly. It is in these complex operations where contracting out can become controversial and contract administration costs expanded. In testimony before the President's Commission on Privatization, Gene Dodaro, Associate Director of the General Government Division of GAO noted that past reviews by GAO and reports by Defense audit groups show a continuing problem in implementing the CA process. In particular, he noted that these problems "...include difficulties in precisely defining the requirements for needed services and in accurately estimating all potential costs". [Ref. 18: p. 3] In fact, Dodaro stated that,

A key implementation concern has been adequate development of the PWS. Past audit reports have shown that PWSs have not always precisely defined all necessary requirements. Task requirements need to be clearly described to reduce the chances for delays and avoid increased costs. Mistakes in the PWS can result in inaccurate estimates of savings.

For example, in a 1985 report we found that in 12 of 20 Defense functions examined, the amount of estimated savings from contracting out was not fully realized. We found that for six of these functions, contract cost increases were caused by errors or ambiguities resulting from inadequate PWSs. [Ref. 18:p. 4]

In complex operations, achieving the precision and clarity necessary to adequately define the performance of work requires a level of resource allocation that most commands undergoing the CA cost comparison process find difficult to absorb "out of hide" (as is currently required by the CA process). Therefore, most commands do not allocate

sufficient resources for the initial formulation of the PWS, and the resulting product is poorly written or incomplete. In the research conducted for this study, all commands that experienced initial performance problems noted that the original PWS was inadequate. Additionally, all operations experiencing these inadequacies were storage and warehousing operations of a relatively complex nature. The return on investment from contracting out complex operations might be improved by allocating the resources used in developing an adequate PWS to other efficiency programs. An investment in automation, improved computer technology and robotics may yield a better return on investment than the CA program in these type of operations. The issue of performance definition, particularly in complex operations, needs to be examined more closely and a determination of the "true costs" of contracting out in these situations closely monitored. After a detailed examination of this issue, policy should be revised either to give more direction in formulating the PWS, to eliminate complex operations from the CA inventory entirely or to financially assist commands that contract out complex operations in the initial stages of the cost comparison process so that adequate resources are devoted to defining performance.

A final performance issue related to the contracting out of operations is the issue of mobilization. Although not directly addressed by our research, this issue continues to

be hotly debated between proponents and opponents of contracting out. Opponents focus on the risk associated with depending upon commercial contractors to provide support under conditions of mobilization. Mobilization is defined as "...the act of preparing for war or other emergencies by assembling and organizing national resources." [Ref. 20:p. 2] Proponents of contracting out state that the private sector has performed admirably in such situations in the past. Neither side has objective evidence or data to support their claims. The Logistics Management Institute performed a study on this issue in April of 1986 and made some initial conclusions about the adequacy of contracted out operations to meet mobilization requirements. They found that,

...mobilization readiness of installation support contractors is generally not a problem. Most contracts are for low-skill housekeeping services that can be easily expanded during a mobilization. The few installations in each Military Department that have major contracts for administrative, logistics, or engineering support services critical to mobilization have taken steps to ensure contractor readiness. [Ref. 20:p. ii]

The study also noted that continued emphasis on the Commercial Activities program by DOD will likely increase the number of contractors providing critical support services. To ensure the readiness of contractors for performance in mobilization conditions, the LMI study recommended that,

...installation managers: (1) have mobilization plans, (2) delineate mobilization requirements in work solicitations, (3) include mobilization clauses in their

contracts, and (4) require contractors to plan for the recall of former military personnel to active duty. Where appropriate, installations should include contractors in mobilization planning and exercises.

We also recommend that installations combine small single-function service contracts into larger multifunction contracts to allow more flexibility in achieving high work force and equipment utilization and to simplify the job of contract administration. [Ref. 20:p. ii]

Despite the findings of the LMI study, this concern will remain an issue until contracted out operations are actually tested in mobilization type scenarios.

#### B. ACCURACY OF COSTS AND BUDGETARY IMPLICATIONS

The majority (approximately 56%) of commands sampled in this research stated that the cost comparison process did not accurately reflect the post-award cost of contracting out. In particular, most noted that the estimate for contract administration was too low. Specifically, the activities in the CINCPACFLT claimancy identified this cost as underestimated, and maintained contract administration staffs in excess of that allowed by the Cost Comparison Handbook. These same commands also had smooth transitions, well informed contract administration staffs, better written PWSs and uniformly good performance throughout the life of a contract. It appeared that the claimancy's investment in contract administration had paid off and most commands were satisfied with the CA implementation process (as they had experienced it). The other claimancies that did not invest in more contract administrative staff than specified in the

Cost Comparison Handbook often had individuals outside the specified staff conducting contract administration duties on a part-time basis. In at least three commands, the secondary attention given to contract administration when it was a collateral duty resulted in diminished surveillance. Other audit reviews also have found the cost estimates for contract administration outlined in the Cost Comparison Handbook to be insufficient. The Center for Naval Analyses noted in their study that:

The concerns that led to this study involved large multifunction or BOS (Base Operating Support) contracts, many of which breached the OMB staffing standards for contract administration. The study team did find that for contracts in excess of \$1 million, OMB standards are lower than staffing levels observed or analyzed in the study. Based on limited data, this suggests that the OMB standards do not reflect custom or practice in the field. The contracts observed in the study were mostly mature, and might actually reflect a lower level of QA staffing than new CA contracts might initially need. [Ref. 19:p. 2]

The Naval Audit Service found in their post-decision reviews that:

The primary reason contracted CAs did not achieve the savings projected by their cost comparisons is that the actual cost of contract administration was substantially higher than estimated. At the time the majority of these CAs were originally studied, contract administration cost estimates were limited to between 4 and 6 percent of the contract price. In all cases, actual costs exceeded these amounts. [Ref. 16:p. 6]

Although the sample size in this study was small, these other reviews appear to substantiate the data that was collected. The estimates for contract administration outlined in the Cost Comparison Handbook appear to be

austere at best, particularly if applied to complex operations. Although the respondents in this research acknowledged OPNAV-443's willingness to negotiate on QA staffing, most indicated that they still were unable to negotiate a sufficient staff to ensure quality performance. Cost savings attributed to the CA Program are therefore somewhat overstated since actual costs routinely exceed the initial estimates. Closer monitoring of contract administration costs through better cost control/accounting systems is warranted. The Naval Audit Service likewise highlighted the need for better cost accounting systems in their post-decisions review of CA activities in which they stated:

The Government needs to develop better 'cost yardsticks' for evaluating CAs after a decision has been made. The existing financial accounting systems do not capture costs by CA function. This makes the development of a cost estimate a long, arduous process. Likewise, these same systems do not capture costs by function after a decision has been made. This makes a comparison of estimated and actual costs very difficult. In addition, the estimates are based on specific assumptions (e.g., prevailing wage rates, scope of work, periods of performance). If these assumptions do not hold, actual costs can not be meaningfully compared to cost estimates unless one or the other is adjusted. Managers need to be aware of these difficulties and to plan better methods for determining cost effectiveness. [Ref. 16:pp. 7-8]

Chapter V provides recommendations on implementing a control system to monitor contract administration and other post-award costs.

Similar to the question raised on the accuracy of the initial contract administration estimates is one on the

accuracy of standard cost factors used in the process. In particular, the factor used to estimate the cost of the Government employees' retirement and fringe benefits was questioned by some sample respondents and major claimants during informal interviews. This factor has been controversial since the program's inception and has fluctuated often during the program's history. The current factor used in CA cost comparisons is 27.05% as announced by the Chief of Naval Operations in March 1988. In contrast, the same factor used to accelerate labor estimates for budget formulation average approximately 16-17%. The inconsistency between these two estimates which purport to address the same factor opens the accuracy of either one to debate. More research into the rationale behind the two estimates and the reason for the difference between them needs to be conducted. Use of standard cost factors (i.e., averages) can distort the accuracy of cost estimates because they tend to inflate the costs of some operations and deflate those of others. If the costs vary widely over a range of functions, the distortion will be more severe.

Another issue that arose during the study was the impact of contracting out on budget flexibility at the command and major claimant level. As noted earlier, during periods of budget cuts the base commander of an activity that has contracted out many functions has considerably less flexibility because a contract represents a legal

obligation. When across-the-board budget cuts are adopted in the Department of the Navy, activities having large segments of contracted out functions may have to absorb these cuts in operational areas if contract renegotiations fail to result in reduced costs. Another option for absorbing budget shortfalls is for the major claimant to absorb the funding cuts at other activities in the claimancy that have not contracted out. In either case, the distribution of the funding cuts may not realistically reflect mission criticality. Critical activities may have their budgets cut merely because less critical activities' funding is tied up in a contractual obligation. In general, CA functions represent base support type activities that impact less severely on mission performance. When these functions are retained in-house, they are normally the first activities to face funding reductions. The impact contracting out has on budget flexibility needs to be closely examined and CNO should provide some general guidelines on alternatives for dealing with funding reductions to those activities/major claimants having large multi-function contracts.

In conjunction with the issue raised on budget flexibility that occurred in this research was the question of the amount of contract flexibility that is available to the local manager based on contract type. Contract type surfaced in this research during the course of interviews

under several different circumstances. In a performance context, whether the contract was a sealed bid (one-step procurement) or negotiated procurement (two-step) appeared to impact directly on quality of performance, especially in complex operations. Based upon data results, negotiated procurement should be the only type of procurement allowed for complex operations.

In terms of streamlining quality assurance requirements and providing more positive incentives to the contractor, several sample respondents indicated the preference for a Cost Plus Award Fee contract over a Firm Fixed Price one. Since the award fee aspect of the Cost Plus Award Fee contract is not subject to the Disputes Clause, the documentation requirements are considerably less, particularly if good performance cannot be assured. A closer cost analysis that determines the difference (if any) of costs between contracted out functions using a Firm Fixed Price contract and those using Cost Plus Award Fee should be conducted. Consideration should be given to determining the true cost of contract administration under a Firm Fixed Price contract as well as a Cost Plus Award Fee contract and any differences in quality of performance that occur under the two options.

Finally, the question of contract type surfaced again in the issue of single function contracts versus umbrella or multi-function contracts, sometimes known as BOS (Base

Operating Support) contracts. Based upon data from the commands in our sample, the activities using multi-function contracts achieved better and smoother operating contract operations. This might be explained by the rationale for using multi-function contracts espoused in the study on contractor performance during mobilization conducted by Logistics Management Institute. In this study, LMI asserted that:

Multifunction contracts provide a more-qualified, efficient, and well-supported management structure. At Fort Eustis, for example, the industrial operations contractor (Northrop) was able to hire retired military officers who had served at Ft. Eustis in a similar capacity....The higher corporate headquarters can also be expected to check the performance of the installation team and to make corrections where appropriate.

Under multifunction contracts, installation personnel have to coordinate activities with only one contractor. Having a single point of contact is particularly important when support from one function either overlaps or is reliant on one or more other activities. With the multifunction contract, determining responsibility in specific functional areas or ensuring that one contractor properly supports another becomes the problem of the primary contractor rather than the Government. [Ref. 20:pp. 12-13]

The advantages of a contractor focal point are mirrored on the government side of the operation since the contract administration staff has a similar focal point in the position of Service Contract Manager (SCM). These two focal points facilitate handling customer complaints. Additionally, often economies of scale can be achieved in the entire contract solicitation, negotiation and administration process since you are dealing with a single, large

contractor. At those activities where there are several functions that are a part of the CA inventory, serious consideration should be given to the option of a multi-function contract to handle all of them to take advantage of these economies.

#### C. TRAINING ISSUES

The final issue that surfaced on the Commercial Activities Program in this research is the adequacy of training. In addition to the training requirements for the contract administration staff noted earlier, several sample respondents expressed concern about the overall expertise within the Navy of the intricacies and options of the CA program and its implementation process. Several commands, particularly those in the NAVSUP and TELCOM claimancies expressed concern over attrition out of the program since a smaller base of expertise had been established in their systems. For these claimancies, where the claimant staff itself consisted of a single person, attrition out of the program could prove particularly devastating. Many of the commands in these claimancies expressed the desire for more comprehensive implementation training than that currently provided as well as a desire for more comprehensive training for the Contracting Officer's Technical Representatives (COTR) and the QAES. The cost comparison process, along with the formulation of the PWS, remain troublesome areas to

deal with for some commands and establishment of training requirements on these areas were cited as needed.

In conjunction with the need for better training of the contract administration and CA implementation staffs, there is need for better training on the part of Contracting Officers (KOs) in terms of the CA implementation process. Based upon a few interviews with KOs involved with contracts at some of the sample activities, there appears to be some gaps in their knowledge of contractual options available to them in CA procurements. Although this assessment is made based upon only limited data, it warrants additional research since the KO normally takes the lead in determining the type of procurement, type of contract and method for technical evaluation. The command undergoing conversion to contract generally must depend upon the KO's expertise to guide them in determining the best contract vehicle for their situation. In a September 23, 1987 memorandum to the Systems Commands, Assistant Secretary of the Navy (Shipbuilding and Logistics) Everett Pyatt emphasized that:

Your continued positive emphasis is expected in assuring that your procurement professionals are trained in the full range of contracting methods and are encouraged to fully employ their knowledge to obtain the best value for the government. [Ref. 21]

Special training for KOs to be involved in administering CA contracts, particularly in the contractual aspects of and options within the CA program itself, might prove beneficial.

In general, more comprehensive, better publicized, and more accessible training on the CA program is needed. NAVFAC provides courses on Quality Assurance, but limits the quotas to NAVFAC activities because the demand for the course is so great. Some CA implementation courses are instructed by personnel who have never experienced the process personally and are therefore not qualified to address "real-life" issues that can actually occur. Overall, an assessment of the training offered on the CA program is warranted and consideration should be given to expanding the number and variety of courses offered in this area.

#### D. SUMMARY OF DATA

The data collected in this research, along with data gathered in audits and reviews conducted by several federal agencies, have pinpointed a number of policy issues and concerns about the CA Program in general and the cost comparison process in particular. These issues include:

1. The need for centralized guidance at the claimant level throughout the CA process.
2. The need for post-award guidance and policy including direction on contract administration and dealing with performance problems.
3. Difficulty in precisely defining performance in complex operations and formulating an accurate PWS.
4. The impact of contracting out on base mobilization.
5. The lack of an adequate cost accounting system to capture post-award costs such as contract

administration and to accurately reflect other costs such as the cost of government fringe benefits.

6. Inadequate staffing of the Contract Administration function.
7. The impact of contracting out on budget flexibility.
8. The impact of type of procurement/type of contract on contract performance and flexibility.
9. The need for additional training on the CA program.

This list summarizes the major policy issues that emerged in this research study. Chapter V presents conclusions and recommends specific actions to deal with these issues.

## V. CONCLUSIONS AND RECOMMENDATIONS

This chapter provides answers to the research questions outlined in Chapter I based upon the information obtained during the data gathering effort. It also presents some general conclusions on the cost comparison process of the Commercial Activities program, and offers recommendations to improve and monitor the accuracy of the process. Finally, the chapter concludes with issues requiring further study.

### A. CONCLUSIONS

The primary research questions used as the framework for conducting this study are presented in Chapter I. The conclusions reached on these questions, based upon the data that was gathered are summarized as follows:

1. There are some unrecorded/underestimated costs associated with contracting out a supply operation.
2. The magnitude of these unrecorded costs are indeterminate because the current cost accounting system is inadequate and is not structured to capture many costs in a manner that is useable to managers attempting to make efficiency decisions. Costs not clearly reflected in the current management information reports on the costs of contracting out include: contract administration costs, performance costs (particularly if a contingency operation is required), litigation costs and clerical support costs related specifically to contract administration. Also not reflected are the cost of training, government employee morale costs and loss of budget flexibility that accrue when an operation is contracted out.
3. The impact of these costs on the activities and their major claimants are generally translated into a loss of managerial flexibility (particularly in the budget

process), a decline in morale (and possibly productivity) among remaining government personnel and sometimes, a degradation in performance.

4. Of all the unrecorded/underestimated costs that occurred in the sample under study, the most significant one was contract administration. This cost routinely exceeded the 4-8% range generally used as the cost estimate during the cost comparison process.
5. There are ways to reduce the number and magnitude of these "hidden" costs. The techniques found most successful in this research were: effective and comprehensive major or sub-claimant program guidance, well-written Performance Work Statements, well-written and well implemented Quality Assurance programs, more centralized guidance on post-award issues and more accessible and better CA training.
6. Although the research did not identify any significant performance differences in the supply operations that were contracted out and those that weren't contracted, objective performance data to support this conclusion was either not accessible or not available from most of the sample commands. The conclusion on performance is based strictly upon the narrative descriptions of contractor performance that were provided by the commands involved in the research effort. An investment in contract administration appears to have been the major factor in attaining and maintaining quality contractor performance, but these costs are underestimated under the current guidelines for the contract administration cost provided in the Cost Comparison Handbook.

In general, the research conducted for this study indicates that the monitoring of post-award events and costs is rather loosely structured in the CA program. This deficiency allows the controversy concerning the success of the program to continue unabated since there is an absence of accurate, appropriate accounting data upon which to base the assessment. Proponents of the program tend to base their conclusions of program success on pre-award cost

estimates that can be misstated as this research indicates. Opponents of the program focus on anecdotal evidence of performance and managerial flexibility problems that are, likewise, not monitored or documented in any systematic manner. This type of evidence is also subject to exaggeration and inaccuracies. Actual cost data on activities that have been contracted out is just not maintained in a form useful for program management. Therefore, in view of the absence of any formal post-award control systems, any determination of the extent of program success or failure may be deemed suspect. The narrative data accumulated in this research indicates that the CA program is ultimately successful in achieving satisfactory functional performance. However, the extent of cost savings attributed to the program is probably overstated in many or most cases. Until deficiencies in the current control systems are resolved, this assessment will be difficult to substantiate objectively.

#### B. RECOMMENDATIONS

Nine CA program issues were identified as the result of this research study. These issues form the structural framework for presenting the recommendations that follow in the next nine sub-sections.

### 1. Need for Centralized Claimant Guidance

The need for centralized guidance at the claimant level was evident in this research and can be addressed by major/sub-claimants implementing the following measures:

- \* Staff CA Program implementation offices with enough personnel to oversee the transition process at field activities. A staff of at least two people seems warranted even at the smaller claimancies to assist in implementation as well as the routine administration of the program.
- \* Field CA implementation teams to conduct on-site assistance at field activities undergoing the CA process. Visits should coincide with significant milestones in the process such as writing the PWS, forming the MEO, conducting the cost comparison, etc. This will allow the activity undergoing the process to benefit from "lessons learned" at other activities within the claimancy who have already undergone the process. It will also develop a "real-life" expertise at the claimant level which is based upon real experience rather than expertise based only on an instruction.
- \* Publish a synopsis of "Lessons Learned" about the CA program on a periodic basis and distribute it widely throughout the claimancy. Solicit regular inputs on lessons learned from activities that have undergone the process. Submit a recap of these lessons to OPNAV-443 on an annual basis.
- \* Convene and chair a command meeting at those commands who will transition to a contractor operation about 60-90 days prior to the transition. Solicit support from the CO, XO, and all Department Heads on ensuring the success of the transition and demonstrate claimant interest and support. Introduce key command personnel involved in the transition and have them highlight contract specifications and possible problem areas. Request the command conduct a follow-up meeting with key Department Heads and other activities that will be serviced by the contract operation to discuss concerns and other possible problem areas.

## 2. Need for Post-Award Guidance and Policy

Current instructions on the CA program focus entirely on the pre-award process with no systematic direction provided on post-award issues. The following recommendations are made to address this deficiency:

- \* Claimants publish a Quality Assurance Manual similar to the one published by NAVFAC to assist commands that have transitioned to contractor operations in establishing and conducting their Quality Assurance programs. The manual should contain policy guidelines on sampling techniques, sample checklists, measurement issues, etc. The manual should basically be a "how to" type of publication that can easily be used by QAEs.
- \* In conjunction with Quality Assurance manuals, claimants establish QAE training courses or obtain quotas from other claimancies offering such courses for each of their commands that will transition to a contractor.
- \* OPNAV-443 issue an instruction dealing with the post-award issues of converting to a contract operation. The instruction should outline possible options for dealing with contractor performance problems including some basic guidance on forming contingency plans and operations. Consideration should be given to streamlining government personnel recruiting and detailing procedures to accomodate the need for quickly assembling temporary operations. Similar stream-lined procedures for bringing onboard a temporary contractor also should be made available and publicized.
- \* Establish a central contingency fund at OPNAV-443 to financially assist commands that must assemble a contingency operation due to poor contractor performance. This will allow the activity to rid itself of deficient contractors until the resolicitation process can be completed. It would also provide OPNAV-443 management visibility of the costs associated with poor contractor performance.

## 3. Problems in Adequately Defining Performance

Despite continued emphasis on developing an adequate PWS and the publication of a few "generic" PWSs to assist commands in PWS formulation, adequate performance definition

remains an issue, particularly for complex CA functions. In order to address the problems of preparing a well-written, detailed PWS and to deal with problems of performance definition, the following recommendations are presented:

- \* The Navy should conduct audits/research on complex operations and multi-function contracts to determine the overall adequacy of the PWSs in these situations. Based upon the findings of the research, either re-evaluate and possibly eliminate some of the more complex operations from the CA inventory or determine what was done to ensure that the PWS was written well. Consider the possibility of funding additional resources during the cost comparison process specifically for PWS preparation. Develop some CA functional experts at the claimant level that are available to assist in PWS preparation for specific functional areas.
- \* Task base commanders with scheduling CA reviews such that the simplest CA functions on the base are reviewed first and the remaining sequence of reviews moves from the simpler functions to the more complex ones. This will allow the development of some expertise on PWS preparation to evolve at the activity before the command attempts to write a PWS on a complex operation.
- \* OPNAV-443 publish an annual list of the commands that have undergone CA reviews sorted by functional area and distribute to the major claimants. Major claimants disseminate the list to commands in the claimancy scheduled to undergo a CA review so that the activity can contact other commands that have undergone a review in the same functional area. This will allow commands to gain access to "proven" PWSs in those functional areas that will be reviewed at their command.
- \* Improve availability and/or publicity of the PWS Preparation training courses.

#### 4. Impact of Mobilization on Contractor Operations

The issue of how contractors will perform under a mobilization scenario cannot be completely resolved until contractors are forced to perform in such a situation. However, to minimize the risks associated with a contractor

performing a support function during mobilization, these recommendations are offered:

- \* Require a mobilization contingency plan as a part of the original contract. Require periodic updating of the plan as a part of the normal report requirements included in the contract.
- \* Commands conduct periodic "mobilization drills" with the contractor similar to those conducted by the Reserves to test the adequacy of mobilization plans.
- \* Include mobilization considerations when determining contract form, evaluating the need for support function coordination. Multi-function contracts may be easier to coordinate and administer during periods of mobilization.

##### 5. Absence of an Adequate Cost Accounting System

This deficiency is major and has an impact on more than just the management control of the CA program. Resolving this inadequacy could require major effort and may be prohibitively costly. However, some minor revisions to the current system would significantly improve current management information available for making CA program decisions. Additionally, further research in this area should be conducted and may result in more recommendations for improving the system. The following recommendations are offered as a result of our limited research:

- \* NAVCOMPT establish a special Activity Group/Sub-Activity Group (AG/SAG) code for Base Contractor Operations. This would allow for separate identification of all functions that are performed by the private sector and government support to these operations. In addition to the special AG/SAG, establish separate Cost Account Codes (CAC) for contract administration, contract operations and contract administration clerical support. This would allow for the accumulation of actual cost data and the establishment of a historical cost data base.

Actual cost data could be used to prepare better cost estimates during the cost comparison process. Also better cost control and program monitoring would be possible.

- \* Conduct additional studies on the Navy's cost accounting system and assess the current policy of using standard cost factors for indirect costs in the cost comparison process. Particular emphasis should be given to the rationale/basis for standard cost factors. Research on the inconsistency between the cost factor used for accelerating government employees' fringe/retirement benefits in budget formulation and the factor used in the CA Cost Comparison process is also warranted.

#### 6. Understaffing of Contract Administration

This research as well as studies/audits conducted by the Center for Naval Analyses and the Naval Audit Service indicate that the staffing levels allowed for contract administration in the Cost Comparison Handbook are not adequate for actual contractor operations. In view of this fact, the following actions are recommended:

- \* Establish an actual cost data base for contract administration based upon the revisions to the Cost Accounting system recommended in sub-section 5. Revise the Cost Comparison Handbook to reflect higher contract administration staffs in those operations where it is necessary.

#### 7. Loss of Budget Flexibility

In those operations which have been contracted out, budget flexibility is greatly reduced. This problem is a difficult one to deal with and can only partially be addressed by implementation of the following measure:

- \* Design/tailor contracts to consider budget reductions. Establish a baseline contract and price that can be scaled down to reduced versions once the contractor has been given 60-90 days notice of the Government's desire to reduce operations. Include as part of the original contract package, modifications that represent reduced

operations (i.e., include stipulations for excluding or reducing certain services that are part of the baseline contract). Require a price quote on the reduced services as part of the original bid proposal with the stipulation that the Government may invoke the reduced version upon proper advance notice. Although this measure does not allow much more flexibility than the option of renegotiation already available, it may reduce the cost of negotiations because they are performed in advance in conjunction with the original contract negotiations.

#### 8. Contract Type and Method of Procurement

The need to tailor contract type and method of procurement to the operation contracted out was highlighted in this study and is fairly well recognized in the systems acquisition environment. Considering the special requirements of the CA process, the measures enumerated below should be considered:

- \* Require that all complex and multi-function operations use negotiated (or the two-step) procurement method. Incorporate this requirement into OPNAVINST 4860.7B.
- \* Conduct a systematic evaluation of the desirability of using a Cost Plus Award Fee Contract for complex and multi-function contracts vice Firm Fixed Price (FFP) contracts. General contracting guidelines stipulate that FFP contracts are not well-suited for complex or poorly defined systems or operations.
- \* Claimants give serious consideration to requiring multi-function contracts vice single function contracts at those activities having a large inventory of CA operations.

#### 9. CA Training Requirements

Additional training in several aspects of the CA program implementation process were identified in this study. Specifically, the following training courses need to be developed or improved:

- \* Specialized training for Contracting Officers who will be administering CA contracts. This training should concentrate on the most appropriate contracting techniques, methods and procedures to use in specific situations. An in-depth presentation of options for dealing with contractor performance problems specifically as it relates to CA functions would also be useful.
- \* Statistical training for QAEs, particularly random sampling techniques and other sampling techniques appropriate to monitoring service (vice production) operations.
- \* Training on performance measurement and conducting quality surveillance.
- \* Increased publicity and offerings of CA courses/tools already in existence. In particular, increased publicity on the automated Cost Comparison software developed at CNET, and on Cost Comparison and PWS Preparation courses is needed.

In summary, the CA program is evolving and the Navy is still learning from its experience with the program. The program is controversial and suffers from the lack of independent and systematic post-award review. In conducting the research for this study, it became apparent that routine program management data is difficult to obtain because it is not systematically collected. In addition, management reviews and audits of the program are also relatively limited and small in number. Many of the management debates currently conducted on the program would benefit greatly from additional studies and research. The next section concludes this study with some topics for additional research.

### C. AREAS FOR FURTHER RESEARCH

The following areas surfaced as possible topics for additional study and research:

- Performance effectiveness and cost savings attributable to functions that remained in-house after a CA Review (implementation of the MEO).
- An in-depth evaluation of the current Navy Cost Accounting System and CA Post-Award Control system.
- Use of a Standard Cost versus an Actual Cost basis in the Cost Comparison process.
- An assessment of the Return on Investment (ROI) of the CA program versus that of other efficiency measures, such as automation, robotics, installation of computer technology and techniques, etc.
- A comparison of the effectiveness and cost savings achieved on Firm Fixed Price contracts versus Cost Plus Award Fee contracts for CA functions.
- An evaluation to determine which type of CA functional areas tend to be more successful under a contractor.
- Research on how to deal with the budget flexibility problem at commands with CA operations. Possible examination of the private sector's handling of this issue on their sub-contracted operations.
- An examination of the private sector's handling of sub-contracted operations to determine if any of their techniques might be applicable to CA program management.
- An examination of current CA operations ability to deal with mobilization.
- Research on the methodology used to determine Government Employees' Fringe Benefits/Retirement Cost Factor (reconcile differences in factor used for Budget Formulation and the Cost Comparison).

APPENDIX A

NAVY COMMERCIAL ACTIVITIES (CA) PROGRAM:  
PROGRAM ACCOMPLISHMENTS FYS 1979-1987

NAVY COMMERCIAL ACTIVITIES (CA) PROGRAM  
PROGRAM ACCOMPLISHMENTS  
FYS 1979-1987

Prepared by CNO (OP-443)  
November 1987  
(Supersedes October 1986  
version)

November 1987

**NAVY COMMERCIAL ACTIVITIES (CA) PROGRAM  
OVERVIEW**

**ACCOMPLISHMENTS:**

- 22,000 positions studied.
- 823 studies conducted.
- \$495,000,000 net program savings.
- 13,000 positions saved through either in-house MEO reduction or conversion to contract.
- 17% In-House MEO Savings Average--FYs 1979-1987.
- 13% In-House MEO Savings Average--FYs 1984-1987.
- 58% of studies result in continued in-house performance.

**CIVILIAN PERSONNEL IMPACT:**

- 59% of civilian positions studied are retained in-house.
- Only 5% of civilian employees in positions eliminated through conversion to contract are separated.
- Only 10% of total Navy civilian positions will be studied under CA Program.

**CONTRACTING ISSUES:**

- Savings estimated during cost comparison are sustained over time (anticipated contract savings--41% vs. actual contract savings--40%).
- 81% of Navy CA contracts awarded to small businesses.
- 68% of annual contract \$ paid to small businesses either as prime or sub-contractors.
- During FY-1987, \$154,000,000 in new business awarded to the private sector (based on the 3-year bid/offer submitted by winning contractors).

**INCENTIVES:**

- MEO savings over 15% retained by activity for other use.
- Navy wins regardless of outcome of study by reducing operating costs.
- In the unlikely event that contracting problems do occur, i.e., excessive cost growth or incorrectable performance problems, return to in-house performance is possible.

November 1987

IN-HOUSE MEO SAVINGS (3 YEAR FORMULA)

PY	POSITIONS SAVED	\$ PER POSITION*	1 YR \$	3 YR \$
79	7	23,100	161,700	485,100
80	0	25,200	0	0
81	1	25,500	25,500	76,500
82	69	27,000	1,863,000	5,589,000
83	492	28,000	13,776,000	41,328,000
84	279	29,400	8,202,600	24,607,800
85	325	29,100	9,457,500	28,372,500
86	236	29,800	7,032,800	21,098,400
87	524	32,900	17,239,600	51,718,800
<b>TOTAL</b>	<b>1,933</b>		<b>\$57,758,700</b>	<b>\$173,276,100</b>

\* NAVCOMPT OP-08 Budget Exhibit figures used. Dollar value shown reflects "per position" salary for the next year after the cost comparison was completed.

November 1987

CONTRACT NEO SAVINGS (3 YEAR FORMULA)

<u>PY</u>	<u>POSITIONS SAVED</u>	<u>\$ PER POSITION*</u>	<u>1 YR \$</u>	<u>3 YR \$</u>
79	6	23,100	138,600	415,800
80	3	25,200	75,600	226,800
81	8	25,500	204,000	612,000
82	119	27,000	3,213,000	9,639,000
83	369	28,000	10,332,000	30,996,000
84	258	29,400	7,585,200	22,755,600
85	62	29,100	1,834,200	5,412,600
86	396	29,800	11,800,800	35,402,400
87	371	32,900	12,205,900	36,617,700
<b>TOTAL</b>	<b>1592</b>		<b>\$47,359,300</b>	<b>\$142,077,900</b>

\* NAVCOMPT OP-08 Budget Exhibit figures used. Dollar value shown reflects "per position" salary for the next year after the cost comparison was completed.

November 1987

CONTRACT CONVERSION SAVINGS (3 YEAR FORMULA)

<u>FL</u>	<u>IN-HOUSE COST</u>	<u>CONTRACT COST</u>	<u>DIFFERENCE</u>
79	\$ 61,994,000	\$37,478,000	\$ 24,516,000
80	23,897,000	18,926,000	4,971,000
81	13,669,000	11,937,000	1,732,000
82	93,510,000	72,467,000	21,043,000
83	264,029,000	185,926,000	78,103,000
84	109,396,000	86,450,000	22,946,000
85	161,531,000	105,690,000	55,841,000
86	212,153,000	162,246,000	49,907,000
87	209,291,000	163,105,000	46,186,000
<b>TOTAL</b>	<b>\$1,149,470,000</b>	<b>\$844,225,000</b>	<b>\$305,245,000</b>

November 1987

**CA PROGRAM ACCOMPLISHMENTS**

**POSITIONS STUDIED**

<u>FY</u>	<u>IN-HOUSE</u>			<u>CONTRACT</u>			<u>TOTAL POSITIONS</u>	
	<u>CIV/MIL</u>	<u>TOTAL</u>	<u>%</u>	<u>CIV/MIL</u>	<u>TOTAL</u>	<u>%</u>	<u>CIV/MIL</u>	<u>TOTAL</u>
79	102/0	102	11	421/439	860	89	523/439	962
80	214/0	214	40	325/0	325	60	539/0	539
81	91/0	91	30	189/25	214	70	280/25	305
82	1119/5	1124	58	783/36	819	42	1902/41	1943
83	3645/96	3741	57	2531/247	2778	43	6176/343	6519
84	1777/53	1830	61	1146/28	1174	39	2923/81	3004
85	1461/46	1507	57	318/837	1155	43	1779/883	2662
86	999/13	1012	40	1334/163	1497	60	2333/176	2509
87	<u>1396/13</u>	<u>1409</u>	<u>40</u>	<u>585/1495</u>	<u>2080</u>	<u>60</u>	<u>1981/1508</u>	<u>3489</u>
<b>TOTAL</b>	<b>10,804/226</b>	<b>11,030</b>	<b>50</b>	<b>7,632/3,270</b>	<b>10,902</b>	<b>50</b>	<b>18,436/3,496</b>	<b>21,932</b>

**NUMBER OF COST COMPARISONS CONDUCTED**

<u>FY</u>	<u>IN-HOUSE</u>			<u>CONTRACT</u>			<u>TOTAL</u>
	<u>NO. OF STUDIES</u>	<u>%</u>	<u>NO. OF STUDIES</u>	<u>%</u>			
79	11	28	28	72			39
80	18	44	23	56			41
81	5	33	10	67			15
82	69	63	41	37			110
82	<u>154</u>	<u>57</u>	<u>114</u>	<u>43</u>			<u>268</u>
84	84	64	48	36			132
85	62	73	23	27			85
86	48	66	25	34			73
87	<u>30</u>	<u>50</u>	<u>30</u>	<u>50</u>			<u>60</u>
<b>TOTAL</b>	<b>481</b>	<b>58</b>	<b>342</b>	<b>42</b>			<b>823</b>

November 1987

**CA PROGRAM STATISTICS**  
**MEO SAVINGS BY FISCAL YEAR**

FY	IN-HOUSE			CONTRACT			OVERALL		
	BASELINE TOTAL	MEO SAVINGS	\$ SAVED	BASELINE TOTAL	MEO SAVINGS	\$ SAVED	BASELINE TOTAL	MEO SAVINGS	\$ SAVED
79	103	7	7	941	6	1	1,044	13	1
80	214	0	0	328	3	1	542	3	1
81	91	1	1	219	8	4	310	9	3
82	1,157	69	6	861	119	14	2,018	188	9
83	3,814	492	13	2,933	369	13	6,747	861	13
84	1,863	279	15	1,216	258	21	3,079	537	17
85	1,517	325	21	1,171	62	5	2,688	387	14
86	1,043	236	23	1,504	396	26	2,547	632	25
87	1,509	524	35	2,157	371	17	3,666	895	24
<b>TOTAL</b>	<b>11,311</b>	<b>1,933</b>	<b>17.09</b>	<b>11,330</b>	<b>1,592</b>	<b>14.05</b>	<b>22,641</b>	<b>3,525</b>	<b>15.57</b>
<b>84-87 AVG</b>	<b>5,932</b>	<b>1,364</b>	<b>22.99</b>	<b>6,048</b>	<b>1,087</b>	<b>17.97</b>	<b>11,980</b>	<b>2,451</b>	<b>20.46</b>

November 1987

## CA PROGRAM SAVINGS

### 1. Studies resulting in In-House Retention:

- a. Savings are computed based on the number of positions eliminated by implementation of the Most Efficient Organization (MEO).
- b. Savings are calculated for 3 years (length of average cost comparison).
- c. Savings (\$) are calculated for each position eliminated using the "cost per position" used in the NAVCOMPT Budget Exhibit OP-08 (for the appropriate fiscal year(s)).

### 2. Studies resulting in Conversion to Contract:

- a. Two types of savings are realized when a function goes contract.
  - (1) MEO Savings.
  - (2) Conversion Savings--Difference between in-house and contract bids.
- b. MEO Savings are computed using the same criteria as in 1. above.
- c. Conversion savings are calculated for the period covered by the cost comparison (usually 3 years).

November 1987

CA PROGRAM SAVINGS  
(All \$ shown in millions)

FISCAL YEAR	IN-HOUSE MEO SAVINGS	CONTRACT MEO SAVINGS	CONTRACT CONVERSION SAVINGS	TOTAL PROGRAM SAVINGS	PROGRAM EXPENSE	NET PAYBACK
79	\$ 0.5	\$ 0.4	\$ 24.5	\$ 25.4	-	\$ 25.4
80	0	0.2	5.0	5.2	1.4	3.8
81	0.1	0.6	1.7	2.4	5.0	-2.6
82	5.6	9.6	21.0	36.2	5.1	31.1
83	41.3	31.0	78.1	150.4	23.3	127.1
84	24.6	22.8	23.0	70.4	24.2	46.2
85	28.4	5.4	55.8	89.6	25.4	64.2
86	21.1	35.4	49.9	106.4	22.5	83.9
87	<u>51.7</u>	<u>36.6</u>	<u>46.2</u>	<u>134.5</u>	<u>18.4</u>	<u>116.1</u>
TOTAL	\$173.3	\$142.0	\$305.2	\$620.5	\$125.3	\$495.2

- NOTES: (1) CA COST COMPARISONS USUALLY COVER A 3 YEAR PERIOD. THE SAVINGS SHOWN ABOVE REFLECT TOTAL SAVINGS FOR THE COMPARISON PERIOD.
- (2) PROGRAM EXPENSE = THE SALARY COSTS OF DEDICATED CA ADMINISTRATIVE POSITIONS.

November 1987

**PROGRAM EXPENSE**

<b>FY</b>	<b>NO. OF ADMINISTRATIVE POSITIONS</b>	<b>\$ PER POSITION*</b>	<b>COST</b>
79	0	21,400	0
80	60	23,100	\$1,386,000
81	200	25,200	5,040,000
82	200	25,500	5,100,000
83	864	27,000	23,328,000
84	864	28,000	24,192,000
85	864	29,400	25,401,600
86	773	29,100	22,494,300
87	616	29,800	18,356,800
(88)	(475)	***	****
<b>TOTAL</b>			<b>\$125,298,700</b>

\* NAVCOMPT OP-08 Budget Exhibit figures used. Dollar value shown reflects "per position" the given fiscal year.

APPENDIX B

INTERVIEW QUESTIONNAIRE FOR  
CA POST-AWARD EXPERIENCES

COMMAND NAME: \_\_\_\_\_

FUNCTION CODE: S713      T801      BOTH    (circle all that apply)

NUMBER OF BIDDERS \_\_\_\_\_

AMOUNT OF WINNING CONTRACT BID: \_\_\_\_\_

AMOUNT OF GOVERNMENT BID: \_\_\_\_\_

PREVIOUS MANNING LEVEL: \_\_\_\_\_

MEO MANNING LEVEL: \_\_\_\_\_

CONTRACTOR MANNING LEVEL: \_\_\_\_\_

NUMBER OF GOVERNMENT EMPLOYEES HIRED BY THE CONTRACTOR: \_\_\_\_\_

1. Has the winning contractor performed satisfactorily since contract award?    YES      NO      (Circle one)
2. If yes, what criteria was used to judge performance? (check all those that apply)

Observation \_\_\_\_\_

Routine Command Performance indicators \_\_\_\_\_

    Timeliness measures \_\_\_\_\_

    Accuracy measures \_\_\_\_\_

    Safety measures \_\_\_\_\_

    Customer satisfaction measures \_\_\_\_\_

External inspection results \_\_\_\_\_

Internal audit results \_\_\_\_\_

Quality Assurance inspection results \_\_\_\_\_

Other \_\_\_\_\_. Please specify. \_\_\_\_\_

3. Do you have the following statistics for both before and after contract award?

### T801 STORAGE AND WAREHOUSING

Receipt-to-stow on-time (%)	Before:	After:
Issues on-time (%)	Before:	After:
Warehouse refusals (%)	Before:	After:
Shipped on-time (%)	Before:	After:
Receipt accuracy (%)	Before:	After:
Issue accuracy (%)	Before:	After:
Ability to meet emergency requirements	Before:	After:
General Warehouse Appearance (cleanliness)	Before:	After:
Local Deliveries On-time	Before:	After:
# Safety Violations (documented)	Before:	After:
# Incoming Reports of Discrepancy (RODs)	Before:	After:
% Items Properly Packed for Shipment	Before:	After:

### S713 FOOD SERVICE OPERATIONS

Sanitation Inspection Results	Before:	After:
Equipment Maintenance	Before:	After:
Financial Returns (Over or Under issue)	Before:	After:
Cycle Menu Development	Before:	After:
Customer Satisfaction Indicators After:	Before:	
Attendance Levels	Before:	After:
# Safety Violations (documented)	Before:	After:

4. Have you ever taken deductions for substandard performance on this contract? YES      NO      (Circle one)
5. If so, (a) how many deductions have been made? \_\_\_\_\_
- (b) what is the average monthly amount of deductions? \_\_\_\_\_
- (c) what is the cumulative amount of deductions? \_\_\_\_\_
- (d) what performance was substandard? (i.e., in what areas was the contractor deficient?) \_\_\_\_\_
6. Have you taken any other actions related to contractor performance? (i.e., Contract Deficiency Reports, etc.) If so, please explain. \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
7. Have any litigation proceedings or claims been filed against your contract? YES      NO      (Circle one)
8. If so,
- (a) what dollar amount was involved? \_\_\_\_\_
- (b) what were the results? \_\_\_\_\_  
\_\_\_\_\_
9. (a) If a claim has been filed, what type and amount of documentation was required of your command?  
\_\_\_\_\_  
\_\_\_\_\_
- (b) What is the approximate number of documents generated in response to claim proceedings.  
\_\_\_\_\_  
\_\_\_\_\_
10. How many personnel at your command are involved in contract administration? Please state their titles, grade level, full-time or part-time (if part-time, give % of time spent on contract administration).  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

11. Can you identify any additional administrative costs associated with administering this contract that you did not anticipate, such as purchase of clocking devices to determine timeframes for government vs. contractor responsibility, dealing with contractor/government disputes, excessive documentation requirements, etc.? \_\_\_\_\_

12. (a) Has any damage other than normal wear and tear been caused by the contractor to government facilities or equipment?

YES                    NO                    (Circle one)

(b) If so, what was the dollar amount of damages involved? \_\_\_\_\_

(c) Did these same type of damages occur when the function was government-operated? YES            NO  
(Circle one)      If not, please explain any differences. \_\_\_\_\_

13. Is this the first contractor ever to assume responsibility for this operation?

YES                    NO                    (Circle one)

14. If not, what happened to the first contractor (i.e., did not exercise option, contract default, or lost resolicitation bid)? \_\_\_\_\_

15. Has the dollar amount of the original bid changed during the course of the contract? YES            NO            (Circle one)

(a) If so, by what amount and for what reason? (i.e., mandatory payraises, change in scope or mission, etc.) \_\_\_\_\_

16. Was the original award (a) a sealed bid or (b) negotiated procurement or (c) neither (Please circle one)

17. Did your command conduct a pre-award survey before contract award? YES                    NO                    (Circle one)

18. If so,
- (a) who performed it? \_\_\_\_\_  
\_\_\_\_\_
- (b) what was actually done? \_\_\_\_\_  
\_\_\_\_\_
19. (a) Did your contract experience many modifications to the PWS during the course of the contract?  
YES      NO      (Circle one)
- (b) If so, what areas were changed and why? (Check those that apply)
- Scope of work \_\_\_\_\_  
Procedural changes \_\_\_\_\_  
Deduction Schedule \_\_\_\_\_  
Performance requirements summary \_\_\_\_\_  
Other, please specify. \_\_\_\_\_  
\_\_\_\_\_
- (c) Did any changes affect contract price? \_\_\_\_\_  
\_\_\_\_\_
20. Was a technical proposal required as a part of the pre-award solicitation process? YES      NO      (Circle one)
- If so,
- (a) who evaluated the proposals? \_\_\_\_\_  
\_\_\_\_\_
- (b) how long did it take? \_\_\_\_\_  
\_\_\_\_\_
21. Was the winning contractor experienced in the type of operation that they are currently performing?  
YES      NO
22. What type of assessment was made of the extent of contractor experience? (i.e., how was it determined?) Check those that apply.
- References \_\_\_\_\_  
Previous work with Navy \_\_\_\_\_  
On-site visits of other operations \_\_\_\_\_  
Other, please specify \_\_\_\_\_

23. Do you feel that the cost comparison process accurately reflects the cost of contracting out? YES NO

If not, why? Check those items that apply.

Performance/quality considerations not accounted for \_\_\_\_\_

4% Administrative cost estimate is too low \_\_\_\_\_

Litigation costs are not accounted for \_\_\_\_\_

Transition costs are more than 10% differential \_\_\_\_\_

Costs for administering RIF procedures not accounted for  
\_\_\_\_\_

Impact on productivity of remaining government workers  
is not accounted for \_\_\_\_\_

Other (please specify) \_\_\_\_\_  
\_\_\_\_\_

Please explain your reasons for those items you checked.  
\_\_\_\_\_  
\_\_\_\_\_

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